THE STATE OF THE DAIRY INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON DEPARTMENT OPERATIONS, OVERSIGHT, NUTRITION, AND FORESTRY

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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SUBMITTED MATERIAL

THE STATE OF THE DAIRY INDUSTRY

TUESDAY, MAY 20, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
OVERSIGHT, NUTRITION, AND FORESTRY,
COMMITTEE ON AGRICULTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:30 a.m., in 1300 Longworth House Office Building, Hon. Gil Gutknecht (chairman of the subcommittee) presiding.

Present: Representatives Dooley, Smith, Stenholm, Rehberg, Peterson, Janklow, Cardoza, Nunes, Holden, King, and Baca.

Staff present: John Goldberg, professional staff; Sam Diehl, subcommittee staff director; Craig Jagger, Stephanie Myers, Callista Gingrich, clerk; Kellie Rogers, Elyse Bauer, Tyler Wegmeyer, Andy Johnson, and Howard Conley.

OPENING STATEMENT OF HON. GIL GUTKNECHT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. GUTKNECHT. Good morning. One of the things they teach you in Austin College is to start on time. And so one of the things we want to start today is at least preferably that we will try to start these subcommittee hearings at the appointed hour.

Good morning. This Subcommittee on Department Operations, Oversight, Nutrition, and Forestry is called to order to hear the testimony on the state of the U.S. dairy industry this morning. I want to welcome all of you here today for this subcommittee's first hearing of the 108th Congress. Many of you will note that dairy was not previously under the jurisdiction of this subcommittee and I want to thank Chairman Goodlatte for allowing our subcommittee to work on this tremendously important issue.

I have a special place in my heart for the dairy producers in my district. There is no harder working group of people than the men and women who get up at 4 in the morning to milk those cows, 7 days a week, 365 days a year.

When I talk to dairy producers in my district there are three basic questions that I hear. The first is why have prices been so low for so long? The second question is what effect is MPC Milk Protein Concentrate having on prices? And the third question is when are prices going to recover?

I hope this hearing will help to answer these three questions. As anyone in this room know, America's dairy producers are facing difficult times, and this is almost always the case, there are difficult

issues for this subcommittee and the Congress to consider. Our farmers are receiving prices at 25 year lows and are experiencing one of the most severe and prolonged price slumps in our recent history. Dairy consumption has slowed recently and fluid milk consumption in the United States has declined steadily for the last two decades.

At the same time, U.S. producers continue to achieve new levels of efficiency and productivity. Through improved management and the use of new technology, producers have nearly doubled milk production per cow over the last 30 years. Herd sizes across the country, and particularly in western States, have increased tremendously. Too often though, gains in efficiency and technology have benefited the consumer without increasing producers net returns.

The dairy industry in my region has had a particularly difficult time for a number of years. Over the last 30 years, Minnesota has lost 38,000 dairy farms, an 84 percent drop. Minnesota's milk production has slumped by almost 20 percent. Despite this, I have great confidence that the upper Midwest can remain America's dairyland, to steal a phrase from our friends in Wisconsin.

I do not blame all of our problems on Federal policy. I believe States like Minnesota must prioritize our dairy industry, and producers must make business decisions to achieve efficiency and responsibly manage risk. State and local Government and our communities must understand the value that dairy and other animal agriculture adds to rural America.

Here in Congress, we altogether too often fall prey to regional and other unnecessary divisions, to the detriment of America's dairy producers. Unfortunately, battles between big producers and small producers; between producers and processors; and/or one region verses another, can keep us from achieving sound policy.

While I don't believe this subcommittee or this Congress will solve all of these problems, I do believe that we can be a part of the solution, by attempting to focus on the facts.

As John Adams said "Facts are stubborn things." And the purpose of today's hearing is to provide the subcommittee with just that, an accurate view of the current state of the U.S. dairy industry. It is my goal to gain a clear picture of what is happening across the country from the various witnesses we will hear from today.

I want to thank our witnesses for coming, particularly those of you who have traveled from across the country, to testify here today. I particularly want to welcome Bill Rowecamp who is an outstanding dairy farmer from southeastern Minnesota and an agricultural leader in our State. I also want to recognize Minnesota's commissioner of agriculture, Gene Hugoson who is here with us today for the hearing.

With that I'll close and recognize the subcommittee's ranking member, our friend and distinguished gentleman from California, Mr. Dooley.

OPENING STATEMENT OF HON. CALVIN M. DOOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. DOOLEY. Well thank you, Mr. Chairman, and I appreciate you calling this hearing in terms of where we can kind of get a better understanding in the state of U.S. dairy industry.

You are all most particularly interested in terms of what are the ramifications of our Government's dairy policies having and contributing to the State. And I am very, very concerned that some of the policies we enacted in the farm bill and particularly the MILC Program, which is projected to cost taxpayers about $2.4 billion perhaps this year. It is contributing to, not only costing the taxpayers that amount of money, but it is also contributing to increase production beyond what market signals are dictating, which are contributing to a reduction in all milk prices, which Dr. Brown is going to point out in some of his analysis, are 25 cents a hundredweight, which are in fact costing dairy producers in my district money, been lost returns from the marketplace. It is contributing to increase of purchases by USDA of butter and powder and cheese, and I think it is time for us to have a serious analysis and assessment of whether or not a program of this nature makes any sense whatsoever, when we are putting taxpayers on the line for billions of dollars, we are costing producers in many parts of the country millions of dollars. And there is really no end in sight.

And so hopefully at the course of this hearing, we can get some ideas in terms of the direction we should be taking our dairy policy that we have in place, so that we can hopefully get to more market based signal that can bring a little more sanity to our existing dairy programs.

Mr. GUTKNECHT. Thank you, Representative Dooley, and with that we're going to get started. The staff has assembled what I think is just an unbelievably talented group of witnesses today, and we are very privileged to have with them.

The Chair will accept at this time any other statements for the record.

PREPARED STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman, thank you for holding this timely hearing. I am very encouraged that you and Mr. Dooley are charging into an examination of dairy policy and I look forward to working with you.

I have great concerns about our direction in dairy policy and about the effectiveness of the policies we have in place. Dairy prices are at a low point right now and that is surely cause for concern. But also of concern is the tremendous volatility that afflicts producers. The all-milk price is now about $11. Nineteen months ago it was over $17; 14 months before that it was under $12; 17 months before that it was at $18 and 9 months before that it was $12. This wild ride takes us back to December 1997. While the cycles of markets may soon provide farmers with relief from current prices, I don't see how we can expect long-term, sound investments to be made in this climate. These conditions and other factors have caused me to believe that we need to all come together and make a fresh start in our dairy policy.

Mr. Chairman, there is a bill pending in this subcommittee—H.R. 1659—which is designed to ensure that a single milk bottling plant in Yuma, AZ is subject to Federal milk market order regulation. I should note that the plant itself is not yet even in business. This bill is regarded as being so urgently needed, that it may soon be brought to the House floor without any committee action at all. As I became familiar with it, I was concerned that the bill would have unanticipated consequences. However, I have been convinced by colleagues on the committee from California—

particularly Representatives Nunes and Cardoza—that action is necessary to avoid the risk of severe disruption in the California marketplace. So while I have come to support this bill, I believe that the fact that we need to legislate with regard to a single facility is a symptom of a deeper problem.

In that context, I note that it is generally accepted that H.R. 1659 would not be needed to ensure the regulatory action sought if California were part of the Federal milk order system. The irony of the situation is that our able colleagues from the California delegation seek the enactment of this change in Federal policy, when the change wouldn't be needed at all if California producers would simply join the Federal milk marketing order system. This is just one way—and there are others—that we find national dairy policy being driven by the vagaries of the California system. As long as California producers choose not to join the Federal order system, I suppose that we will continue to have to make accommodations and adjustments that are driven by features of that State's system—features that we in Washington do not have the ability to affect.

Mr. Chairman, another dairy policy situation provides more evidence. A little-discussed provision in the Agriculture Appropriations bill for fiscal year 2000 has made handlers in Clark Co., Nevada (which includes Las Vegas), exempt from milk pricing regulations that apply throughout the rest of the order system. To my knowledge, no person has testified here to explain why processors in Clark County should receive such Congressional favoritism, yet the policy stands.

And of course, Mr. Chairman, the dairy economy itself and the hardships faced by farmers, despite the farm bill's continuation of price support and the establishment of a new payment program, are also bad signs.

Mr. Chairman, when we have to legislate to regulate one particular plant, or to deregulate one particular county, or we spend billions of dollars and fail to ensure an adequate living for our dairy farmers, I do not see how we can possibly think that we have gotten our policies right.

So we are privileged today to have witnesses who can help show the way to a better dairy policy.

Among them is the University of Missouri's Dr. Brown who has brought with him a FAPRI (Food and Agricultural Policy Research Institute) paper he recently authored which is titled: "The Effect on the United States Dairy Industry of Removing Current Federal Regulations." The title itself is a bold idea and, as far as they go, the study's results suggest that our industry could survive some changes.

And so, Mr. Chairman, we will receive testimony from all of our witnesses that will point us toward a new beginning. We should start anew on dairy policy—as if we had a blank sheet of paper. And analysis such as that by Dr. Brown will greatly help us to see our way towards a new plan.

Mr. Chairman, once again thank you for holding this hearing. I thank our witnesses for being here and I ask that they continue to work with us and each other—and help this committee meet its challenge of designing a modern, logical, and coherent dairy policy.

Joe Baca

CONGRESSMAN JOE BACA
OPENING STATEMENT
HEARING ON DAIRY ISSUES
SUBCOMMITTEE ON DEPARTMENTAL OPERATIONS, OVERSIGHT, NUTRITION AND FORESTRY
COMMITTEE ON AGRICULTURE

Mr. Chairman, thank you for holding this hearing.

I appreciate the opportunity to review the testimony today regarding an industry that is important to the agricultural community in my district and neighboring region.

While there are many pressing dairy issues, there is only one that I wish to address today – Milk Protein Concentrates. Imports of MPCs are increasingly entering the United States with minimal trade restrictions.

As you and our colleagues know, MPC is a general reference to a dried protein product derived from milk using a technology known as "ultra filtration." From economic studies, we know that MPCs clearly substitute for domestically produced nonfat dry milk. When this occurs, CCC purchases under the dairy price support program increase if the wholesale price of nonfat dry milk is at or below the support price.

In essence, what we have is a loophole in our trade agreements that should have been solved in the Uruguay Round Agreement on Agriculture. I will not hide my support for legislation to increase the tariff on MPC imports or the need to include MPC imports as part of our nation's WTO negotiations on agriculture.

The data clearly shows that increased imports of MPC occur whenever the Northern Europe price of nonfat dry milk falls below the U.S. price, creating an economic advantage to the importers of the product. We know that MPCs are being imported, and the economic conditions as to why this happens, but the question is how much economic damage?

While the econometric studies are underway and some preliminary studies are still being formed or reported – the conclusion is that MPCs are financially damaging the domestic dairy producers, and the United States Treasury. I will not debate the issue of financial damage to the producers because the verdict is still out on how large of a financial blow MPCs imports are having on domestic producers. So far, all information thus far seems to indicate a substantial financial damage of a reduction of 8.6 cents per cwt or $157 million per year.

Clearly, a diminished demand for nonfat dry milk creates economic conditions that result in lower milk prices, hence more CCC purchases. In my view, and I believe this a credible argument, these CCC purchases are in effect paying for the cost of MPC imports. The United States has in essence become the CCC for the world's surplus milk production, which is converted into MPCs and shipped with little or no tariff to the U.S. where it will certainly displace domestic milk, which is then bought by the CCC. This is a financially unsound policy and shows the necessity of tariffs.

These imports are heavily subsidized abroad, and they are not even accurately measured since they are often miscategorized and misidentified. The amounts of MPCs being imported for direct substitution of nonfat dry milk are certainly much higher than we know.

I believe the solutions are clear: 1) regulate the MPC market or 2) tariff it to end the trade distortion that encourages MPC use as a substitute for nonfat dry milk, the latter being the most prudent.

There are two categories of casein and two categories of MPC imports under the Harmonized Tariff Schedule codes. Imports of all four categories of casein, caseinates, and MPC have increased over the last several years. None of these categories has a WTO tariff-rate quota, and all have very low tariff rates ($.0037 per kilogram for MPCs and Caseinates, and no tariff for casein). Simply, the need to increase our tariffs on MPC and casein is not only warranted, it is absolutely necessary.

The effect of these tariffs are also shortchanging our nation's consumers due to the increasingly common practice of violating FDA regulations for standards of identity of cheese. The recent FDA enforcement actions only serve to prove this case.

Due to the clear and negative effect that imports of MPCs are having on the domestic dairy producers and the US Treasury, I highly suggest that this committee recommend to Ambassador Zoellick that our nation demand a WTO tariff-rate quota on MPCs, and that the committee recommend to the Ways and Means Committee an immediate mark-up of HR 1160.

Thank you Mr. Chairman, and with the Committee's permission I would like to introduce for the record several studies from Dr. Ken Bailey of Penn State. While I disagree with quite a few of his conclusions, he does present an interesting econometric study of the impact of MPC imports.

Thank you and I yield back the balance of my time.

Opening Statement of Congressman
Frank W. Ballance, Jr.
Subcommittee on Department Operations
Oversight, Nutrition, and Forestry
Committee on Agriculture
May 20, 2003

Mr. CHAIRMAN. I thank you for calling this hearing today on the state of the Dairy industry. Mr. CHAIRMAN, the dairy industry is hurting. Farmers have to make a choice about whether to sell their herds and farms and get out of their business or stay in and risk losing everything.

The family farm preserves a critical way of life in rural communities. Family farms are small businesses that feed, service, and support rural communities. They borrow from local banks, buy from local suppliers, and reinvest in local businesses and communities.

Mr. Chairman, there is an expression that as agriculture goes, so goes the American economy. Not a day goes by for me in North Carolina, as I am sure not a day goes by for my other colleagues on this committee that a farmer does not approach me and tell me of his plight. Of crippling commodity prices, drought, and the fear that they too will soon go the way of the auction route, just as so many of their friends have.

Just the other day, I spoke to a farmer from Middleburg, North Carolina who was near tears. He had 150 acres of tobacco, now down to 70. He has nine tractors and now he only needs two.

Dairy farmers are in the same trouble. I have met with dairy farmers from North Carolina who are facing the lowest commodity prices in twenty-five years. So many dairy farmers have gone bankrupt that

the State of North Carolina is now milk deficient. Where at one time, milk needed to be imported only three months out of the year, now it must be imported twelve months out of the year. I fear that this is a crisis that we cannot farm our way out of, and the federal government must act.

I am a cosponsor of H.R. 1160, which would help dairy farmers a little by limiting the amount of Milk Protein Concentrate imported. So I thank the chairman and ranking member for their hard work and attention to this critical area and look forward to working with them to the mutual benefit of our rural communities. Thank you.

Testimony
U.S. Rep. Ron Kind
House Committee on Agriculture
Subcommittee on Dairy

Tuesday, May 20, 2003

Thank you, Chairman Gutknecht, Ranking Member Dooley, and other members of the subcommittee for holding this important hearing. With our nation's dairy producers currently receiving near-record low prices, it is timely that this committee reviews the current status of the industry.

As many of you know, my congressional district is one of the largest dairy producing regions in the nation. Dairy is the economic cornerstone of Wisconsin's economy, providing $18.5 billion in annual revenue. All told, Wisconsin's 125 cheese plants, 12 butter plants, 10 ice cream plants, and 205 plants that manufacture one or more dairy products pump more than $35,000 per minute into our state's economy.

Fueling this productivity are Wisconsin's roughly 1.3 million dairy cows and 17,000 dairy farms. According to data provided by the Wisconsin Milk Marketing Board, on average, each dairy cow generates more than $2,300 a year in direct income to producers, plus an additional $13,200 per year in community income.

Unfortunately, the dairy industry is struggling nationwide. Due to excess production derived largely by robust expansion in the West, as well as a stagnated national and international economy, and an ineffective federal dairy policy that continues to favor some regions over others, Wisconsin's dairy industry is experiencing continued economic pressures.

While many dairy farmers are involuntarily exiting the industry, many new, larger-scale, non-traditional, dairy set-ups have come on-line. However, as the sale ads in the state agriculture newspapers show, these new operations are not immune to the same economic crisis gripping our smaller-scaled, traditional dairy farms.

As we are all aware, the federal government has been an active participate in the national dairy industry. The U.S. Department of Agriculture (USDA) has established a patchwork of programs that serve as a band-aid to national dairy policy. Unfortunately, these band-aid solutions have created numerous problems that in turn have been met with additional counter-intuitive proposals that cause even further distortions. As such, it is high time that this committee, this Congress, and this Administration, approach federal dairy policy from a new perspective. A first step on any new dairy proposal must ensure price equitability. The vast majority of dairy farmers in this nation support a uniform national policy that prices milk equitably, thereby enabling dairy farmers in all regions to prosper and grow.

When reforming federal dairy policy, Congress must review the implementation and effectiveness of the milk price support program. The current milk price support program establishes a $9.90 per hundredweight price for milk. However, the April Class III (manufactured milk) price of $9.41 per hundredweight is roughly 50 cents below the $9.90 per hundredweight price mandated by Congress. Many dairy producers believe that the current price support program has failed and does not provide the level of price support envisioned by Congress when it was first enacted.

The bright spot in otherwise dreary industry is the Milk Income Loss Contract (MILC) program that was established as part of the 2002 Farm Bill. While not every producer is satisfied with this program, we must remind ourselves that this program is providing much-needed direct income to producers in all regions of the country. Unfortunately, this program is threatened by cost overruns due to the anemic dairy market. Unlike other divisive regional approaches to dairy pricing, the MILC program provides assistance to producers throughout the nation. Unfortunately, some industry officials naively believe that the creation of this program has unintentionally propped-up inefficient producer who would otherwise exit the industry. Such reasoning is foolish and misleading.

According to the U.S. Department of Agriculture's 2002 milk production report, published in April 2003, the largest growth in the dairy industry occurred in the West. Specifically, comparing February 2003 with that of a year ago, California production was up 4.7 percent, Idaho 7.3 percent, New Mexico 8.1 percent; while Wisconsin's production was up 0.5 percent and Minnesota saw a decrease of 3.1 percent. Thus, it is readily apparent that the MILC program cannot be blamed for the growth in U.S. milk production.

Rather than continuing the failed regional dairy fights, and applying more of the same old band-aids, it is imperative that we as policy makers begin discussing a wholesale revamp in federal agriculture policy. Specifically, new and innovative methods must be developed that provide income assistance while not distorting the marketplace. While some advocate the radical approach of complete and abrupt withdrawal of federal financial assistance, such an approach is dangerous and does not consider the various needs and circumstances of the changing and competitive dairy industry.

As such, future dairy policy must provide adequate transition mechanisms, which give farmers and rural communities adequate time to adjust to the changing realities. At the same time, as policy makers we need to consider the multi-functional benefits those healthy dairy farms provide for every American citizen. The dairy industry provides numerous environmental, social, cultural, and economic benefits. These benefits include clean water and air, recreational opportunities, beautiful scenic pastures, and numerous agriculture-tourism opportunities. In encourage the committee to consider the multiple purposes that the agriculture industry provides our nation.

Thank you for the opportunity to testify before your committee and provide you with an overview of the current dairy industry and a blueprint for its future. I stand ready to assist you in all your endeavors.

STATEMENT OF
MR. OBEY OF WISCONSIN
BEFORE THE
SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
OVERSIGHT, NUTRITION AND FORESTRY

MAY 20, 2003

CONGRATULATIONS TO CHAIRMAN GUTKNECHT

I wish to congratulate Chairman Gutknecht and the members of the Subcommittee for this hearing. It is long past time that the issue of national dairy policy was seriously considered in the House of Representatives and in the Agriculture Committee. I hope this hearing is an indication that the Subcommittee will take the matter seriously and pursue a policy that will restore farm milk prices.

FARMING COMMUNITIES REPRESENT AMERICAN VALUES

Small-sized family dairy operations still dot the landscape of many parts of our rural countryside adding a vital piece to our cultural heritage, to what it is to be an American. Those small operations feed small towns and villages, the very communities where American values were born and where American values still reside. And those communities in turn feed larger towns and cities where American dreams are made.

But, I ask you to look more closely. Those small towns and rural communities are deeply troubled. Dairy farmers are getting the same for their milk – about $10 per hundredweight – as they were 25 years ago. Who here would accept the same pay for the same job for 25 years with no COLA and no inflation adjustments? There are, of course, many social ills associated with chronic low prices, including increased rates of suicide and divorce among farm families. The land itself is losing value. The Milwaukee Journal-Sentinel reported this week

that the average value of Wisconsin farmland for tax purposes could plunge into negative territory next year. This situation is not sustainable.

THE CAUSE OF CHRONICALLY LOW FARM MILK PRICES

People say dairy is complicated. In fact, it's quite simple. The problem is a chronic imbalance between supply – how much American farmers produce together with how much we import from New Zealand, Europe, Canada, Australia and elsewhere and demand – how much we need for consumption here in America together with what we export or provide as food aid.

Now, on the demand side, things have been going like gangbusters for years although, like everything else the market has slowed under the economic downturn. We have all kinds of fancy dairy products these days, we see TV ads, magazine ads and billboards with famous celebrities, we have the choice of low-fat this, organic that, lactose-free whatever and zero cholesterol something else. Many, many people through advertising companies, media firms, market research, household profiling, packaging, distributing, retailing, are doing everything they can to sell milk in all its varied forms.

But, their efforts are not enough to deal with the problem of chronically low farm milk prices. We need to better manage the supply of both imported dairy products and domestic production of milk.

INTERNATIONAL LEAGUE OF DAIRY CORPORATIONS

Now a coalition of the largest dairy processor corporations in America and their various trade associations have teamed up with powerful allies in the form of French, Canadian, Danish, Dutch and other foreign dairy corporations together with a handful of "advocacy" organizations that don't have a decent word to say about any farm policy since Herbert Hoover. The effect, if not the purpose, of this global alliance is to keep the price that American farmers get for their milk low while keeping the profits of the international dairy corporations high.

MILK PROTEIN CONCENTRATE

The main weapon, currently, of this International League of Dairy Corporations and its allies is the Milk Protein Concentrate (MPC) loophole to our tariff schedules. Here, because of an oversight by our trade negotiators during

GATT – one of many, I suspect – is a dairy product that enters the country with an artificially low tariff, one that is appropriate for an industrial product rather than a food product. A flood of MPC imports since enactment of GATT undercuts domestic dairy prices, displaces domestic dairy products, cost taxpayers hundreds of millions of dollars and helps keep dairy prices low.

Now, you can argue that imported MPC is not the sole cause of low dairy prices. And you'd be right. Other factors contribute. You can argue that fixing the loophole won't make a huge difference to the price the American farmer gets for his milk. You would be wrong. Experience tells us that even a very small change in the level of dairy imports or domestic production can have a big impact on farm milk prices. Capping MPC imports, combined with other steps to control domestic oversupply, can have a dramatic impact on farm milk prices.

SHERWOOD-OBEY MITEA LEGISLATION, HR 1160. DAIRY IMPORT MANAGEMENT

Imported MPC from Canada, Europe and New Zealand is without question a contributing factor to the problem of chronic low farm milk prices. Control of Imported MPC through an appropriate tariff is without question part of a solution.

A bill Congressman Don Sherwood and I have introduced has the support of more than 120 Members of the House. Our legislation would not block one ounce of imported MPC. It would, however, establish a cap on imports and ensure that, over time, the dairy industry in the United States can develop a domestic MPC industry. Apart from the impact the MPC loophole is having today, this legislation is vitally important when you bear in mind that national and international cheese companies have asked the Food and Drug Administration to change the Standards of Identity for cheese to allow them to use MPC as an ingredient in cheese. If the MPC loophole is not closed before FDA approval then the current flood of imported MPC will become a torrent.

I understand that the MPC legislation is not within the jurisdiction of this committee. However, other committees look to this committee for guidance on dairy policy. As such, I would urge you to ask the Ways and Means Committee to take up the matter.

OBEY-SANDERS, FAMILY DAIRY FARMER PRESERVATION ACT, HR 1990 – DOMESTIC PRODUCTION MANAGEMENT

While closing the imported MPC loophole is necessary, it is not sufficient to deal with the problem of chronically low farm milk prices. During floor debate on the Farm Bill last year, Congressman Sanders and I proposed a supply management option for domestic milk production. Our amendment won the bipartisan votes of 194 members of the House. Due to the strong House vote in support of our proposal, it was, for some days, the model for the dairy title of the Senate Farm Bill. Since that time, the National Milk Producers Federation, representing dairy farmers of all sizes and regions of the country, has developed a supply management option of its own.

Congressman Sanders and I have reintroduced our proposal, the Family Dairy Farmer Preservation Act, which will establish a better dairy price safety net through supply management incentives. I believe this is the appropriate starting point for a vigorous debate in the House over the future of dairy policy.

OTHER ISSUES

More can be done and much more vigilance on the part of this Subcommittee is called for. The Administration is proposing new trade deals with Australia and New Zealand that could present American dairy farmers, and farmers of many other commodities, with their biggest challenge yet. At the same time, the courts are reviewing arguments about the California milk pricing system as, again, dairy policy pits region against region, dairy farmer against dairy farmer.

Congress, the House and this Subcommittee can be a leader in restoring some value to dairy farming in America. First, acknowledge the failure of current policy. Then, take the necessary steps to address it by bringing supply and demand back into balance so that the market can work as it is intended to do. Alternatively, as has been the case far too often, this committee and the rest of the House can all just sit aside, let the international league of dairy corporations have its own way, while we allow the American communities that provide the food and fiber that feeds our nation and as well as the values that hold us together to slowly disappear .

The choice is ours to make.

Mr. GUTKNECHT. The first panel includes Dr. Keith Collins, who is the Chief Economist for the U.S. Department of Agriculture; Dr. Robert Cropp, professor emeritus of agriculture and applied economics at the University of Wisconsin; and Dr. Scott Brown, research assistant professor at FAPRI at the University of Missouri.

Dr. Collins, you may begin when you are ready.

STATEMENT OF KEITH COLLINS, CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE

Mr. COLLINS. Thank you very much, Mr. Chairman, and members of the subcommittee. On behalf of USDA, I thank you for the opportunity to be here and begin this hearing to provide information on the economic situation in the U.S. dairy industry. I'm going to provide USDA's current assessment of the market situation for milk and dairy products, and then say a couple of words about how we are providing assistance to the Nation's dairy producers.

The current dairy situation traces to the 1996–2001 period when returns for dairy producers were generally favorable, and that provided an increased incentive to produce more milk. In 2001, poor weather led to a 1.2 percent drop in milk production, and that was the largest decline since 1984, nearly two decades. That created further incentives to expand milk by driving the all milk price to $15.04 a hundredweight, the second highest level ever in 2001.

The following year in 2002, milk production rose 2.6 percent, twice the average rate of the previous 10 years. Now that production increase combined with weak demand caused the all milk price to decline last year by $3 a hundredweight down to $12.19. As production has expanded, we have seen the continual shift to larger operations in the United States. Last year, operations of 500 head or more were responsible for 42 percent of U.S. milk production and that compares with only 30 percent just 5 years ago. And we have also seen the continuing geographic shift toward the western States, although we have seen some increases in some midwestern States as larger dairy operations have come in there.

At the start of this year, 2003, U.S. milk production was still increasing a high rate. Demand remained weak, and stocks of manufactured dairy products were up sharply. Our most recent data suggests that this down trend may be beginning to turn. Take a look at the year over year milk production increases for the U.S. as a whole in the 20 major States. In January, production was up 1.5 percent from a year earlier; in February, 1.3 percent; in March 1 percent; and in April, the data just released, up .6 of 1 percent. For all of the calendar year of 2003, we forecast production will be up about 1 percent.

An important factor on how fast dairy markets recover will be the growth in commercial use. While milk production was up 2.6 percent in 2002, commercial use rose only 1 percent. Cheese growth has been below trend. For 2003, growth in dairy product demand is expected to pick up, particularly as the economy strengthens in the second half of the year. And that should help the food service and grocery store sales. However, the demand growth is probably not going to be enough to meet the increase in milk production or pull down product stocks and boost prices appreciably.

For all of 2003, we forecast that the all milk price will fall another 84 cents a hundredweight, and average $11.35 a hundredweight. Over the past year, USDA's programs have helped support dairy markets, and to stabilize the incomes of producers. For example, we are now purchasing all three products under the price support program, butter, cheese and nonfat dry milk. We have used all of our available quantities for cheese and nonfat dry milk under the Dairy Export Incentive Program. And we announced another 5,000 tons of butter DEIP yesterday afternoon.

Under the Milk Income Loss Contract Program, we've paid about $1.4 billion to date since payments started last October in that program. And as Mr. Dooley, said we expect to pay out about $2.4 billion this year. For all of 2003, the milk payment rate could average $1.60 a hundredweight, and that would be equivalent to a 14 percent price increase for producers who are producing less than 2.4 million pounds.

In summary, milk prices are at 25 year lows. I think markets are showing the beginning signs of returning to balance. And USDA is operating a large portfolio of programs to help producers, during this adjustment process. That completes my comments, Mr. Chairman.

[The prepared statement of Mr. Collins appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Dr. Collins. We will have questions later. Dr. Cropp.

STATEMENT OF ROBERT A. CROPP, PROFESSOR, AGRICULTURAL AND APPLIED ECONOMICS, MADISON, WI

Mr. CROPP. Thank you, Mr. Chairman. Also thank you for inviting me to supply some testimony in this important hearing. I will address briefly the issues that was in the invitation letter, and the first one that Dr. Collins has covered is our milk prices.

It is indicated that the last 3 years prices being depressed, 2000 very low. Recovered nicely in 2001, with some record high prices and up to the second highest milk price in record, and then down again in 2002.

To continue that way should indicate that what causes this is relatively small changes, either in the production side or consumption side. Previously, it is predominantly the production side prices to recover in 2001, simply because cow numbers went down, production declined about 1 percent. Last year has indicated cow numbers went back up again, production up about 2.6 percent. But the other thing I would point out is that milk prices would be a heck of a lot better if we had the same trend in consumption as we had in the past 10 years, about 2 percent. It is indicated now and it appears that production is continuously slow. Last Friday's production report showed cow numbers finally going down after growing month-to-month through all of last year, down only 11,000 head, but that is the turning side. And production per cow is not doing very well, so up 0.8 of a percent or so, or 6 cents for estimated for the total United States. Well if we had to purchase consumption, 1 to 2 percent, we would have milk prices a couple of bucks higher. So it is ever since September 11 and the slowing for 2001 and the

slowing economy, there has been a change in consumption patterns, particularly in cheese.

So the turnaround is going to have to come predominantly on a production side. We do not foresee any major change in commercial disappearance in the near future. Hopefully, it does recover.

So milk prices all of last year most of the time below $10 base class III price, got down as low as $9.11. Some of the time it has been below support level. I think we have bottomed out. It will slowly recover. I could see a little more optimistic than USDA, I could see getting to maybe $11 by July, and I would say $13 is not impossible. I know that is in a minority, but weather has a lot to do with it. The long period of low prices I do see at least by the amount things improving.

As far as a comment on that production, I have a table there that shows most of the growth has been in the West. Minnesota goes down, Wisconsin is kind of stable, Northeast is kind of stable. And a fair amount of drop in production in the South, Southwest.

A comment on dairy trade. A little bit is that a lot of emphasis is put on that in terms of impacting prices. I would say our milk prices predominantly responding to domestic supply and demand. Actually on a total-solids basis, we exported more dairy products than we imported last year. Of course the attention has been on milk protein concentrates. Again, that makes good coffee shop talk. That is the primary reason prices are low. I am not saying there is no problems here, but basically, if you look at the imports of that, it is not a total substitute for nonfat dry milk, which is about 36 percent protein. Milk protein concentrates, and we have from 40 to 90, that what product we are talking about, and it doesn't have the lactose that are with nonfat dry milk, so the functionality, the ability of that sometimes is, even though it may be more expensive, preferred over nonfat dry milk. What it does do is increase the cost of the price support program. Maybe being somewhat generous, we could say maybe 300 to 400 million pounds of nonfat dry milk, displacement imports last year, maybe that is an estimate, but we bought over 800 million pounds of powdered milk. So we still would have had a surplus of powder and prices, even without that.

As far as industry trends, the trend to fewer and larger dairy farms has been going on for a long time. It will continue, regardless of what dairy policy we adopt, unless it is an extreme change in our policy. We have lost about 50 percent of the farms from 1990 to now. If I said we will lose a third of our farms the next 5 years, that is possible. And if you looked at a table I have in there of farm structure, I think Dr. Collins referred to that, when you look at the structure, that we have 48 percent of our herds, less than 50 cows producing 7.6 percent of our milk. Let's face it, 30, 40 cows it is very difficult to support a family, unless there is a substantial off-farm income, or some other farming enterprise. And frankly, with a lot of young people, there are not a lot of young people that wish to milk in the 30, 40 cow farm that is old and obsolete 7 days a week. There are some. So regardless of what we do, I mean some of this is a way of life, and you could look at the larger farms there that are decreasingly producing a larger share of the production.

That is not all price the dairies for production is growing. It has got the lowest milk prices in the country. Some of the highest milk

prices that experience some of the greatest loss, some of the South, southeastern part of the country. Minnesota, Wisconsin, we pay more for milk togo into cheese than any State; $1 hundredweight higher than the rest. Basically saying that we need to improve our farm level production, and face that, regardless what dairy policy is passed.

Effects of government programs. You would have to say that Milk Income Loss Contract Program has surely pumped a lot of money into both Minnesota and Wisconsin. But about 80 percent of the farmers in the country receive full benefit, because they have less than 130 cows. If you added $1.20 to the $12 milk price last year, you have got over $13 price of those farmers, you have to say that has prevented a decline in dairy farms. In my own State of Wisconsin, from May to May last year we cut the decline of dairy farmers in half in Wisconsin, to the extent that it has slowed the reduction in milk production, as of course then, milk prices for the larger operations. But it is simply saying, that is preferred policy in our area, and I think in the manufacturing area over say regional dairy compacts.

The support price, this comment: the $9.80 support price provides a limited safety net, but we have been below the support price many months this past year, as low as $9.11 this last year. So the program is not working. I ask your help the Producers Federation suggest a change of the make allowance, reflect the cost of selling. That is one alternative. Another one is to look at the Commodity Credit Corp if they buy right off the C.M.E. One way that needs to be addressed is whether a comment there, I think the Secretary of Agriculture should have the discretion to adjust purchase prices, without the political pressure of because of the effects say a class mover should have. Look at the full intent of the program, achieve the program at minimal cost.

My last two comments on the future policy is if we want a efficient dairy industry, we have got to let markets work. And that means the upper Midwest farmers, where I come from, need to face that reality, and be competitive in production and marketing, because milk production will gravitate to the lowest cost production areas, and I think that could be the West, it could be upper Midwest, it could be the Northeast. And I think milk prices will flatten across the country as cost production becomes more uniform.

If you want to preserve a farm structure, it would take a drastic change, a real strict mandatory and quota system. That doesn't work, even in Canada, because it can capitalize and change. So maybe somewhere in between, but this structural change is going to continue. And an average all milk price and that $13 range will probably give us all the milk we need in this country to satisfy the demand. That is the reality. Thank you.

[The prepared statement of Mr. Cropp appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Dr. Cropp. Dr. Brown.

STATEMENT OF D. SCOTT BROWN, ASSISTANT PROFESSOR, FOOD AND AGRICULTURAL POLICY RESEARCH INSTITUTE, COLUMBIA, MO

Mr. BROWN. Mr. Chairman, and members of the subommittee. Thank you for the opportunity to be here today, to discuss the current state of the dairy industry. My remarks will focus on how policy, trade, and supply and demand factors have been important in determining today's market situation. In my remarks today, I will not condone or condemn any of the current policies in place in the dairy industry. The institute that I am a part of, the Food and Agricultural Policy Research Institute, strives to remain an unbiased objective unit that stands ready to provide Congress with a quantitative assessment of any agricultural policy alternative.

The dairy industry is experiencing some of the lowest milk prices since the late 1970's. USDA's preliminary April all milk price is $10.90 per hundredweight. This is a decline of over $2 per hundredweight relative to the previous 5 or 10 year average for April. Many factors are responsible for the current market price situation. Demand for dairy products has been soft since late 2001 due in part to a weaker, general economy than many experts had expected. Commercial disappearance on a milkfat basis grew only 0.5 percent in 2002. Although there may be some signs that demand for dairy products is starting to turn around, commercial stocks of dairy products will need to be drawn down before prices can rise.

The supply side of the picture has also contributed to low milk prices. Milk production expanded by 2.6 percent in 2002, in response to the $15 all milk prices that we saw for the annual average in 2001. Thus far in 2003, milk cows remain near 9.15 million head, the latest milk production report did show April cows down 15,000 head in the United States, the first decline we have seen in several months.

Although dairy product trade has caught the attention of many in the dairy industry, changes in the trade picture are not a major factor in the current outlook situation. The current FAPRI projections would suggest that milk prices will rebound in the second half of 2003, but will remain low by historical standards. Recent increases in dairy cow slaughter should begin to impact milk supplies in the coming months, and allow for some strength in milk prices.

With respect to some of the long-term market and policy issues, FAPRI has recently completed a broad examination of current Federal dairy policy in a report attached to my testimony. The research examines the Milk Income Loss Contract Program, the Dairy Price Support Program, the Dairy Export Incentive Program, and the Federal Milk Marketing Order System.

The MILC Program has received considerable attention in the wake of recent low milk prices. Some have argued that the MILC Program is responsible for the current milk price declines. It is clear that the MILC Program does lower milk prices as producers respond to the additional payments made under the program. However, the current FAPRI estimate suggests the all milk price would only be 25 cents higher in 2003, in the absence of the MILC Program, suggesting that much of the current decline in milk prices is due to the fact there is other than the MILC Program. In terms

of the current outlook, the MILC Program likely prolongs adjustments in milk supplies to the current low milk prices.

To date, over $1.3 billion has been sent to milk producers under the MILC Program. Current FAPRI estimates suggests that during the life of the MILC Program outlays will reach $4.8 billion. With the 2.4 million pound marketing's cap on benefits, the MILC Program benefits small dairy producers. This benefit can be seen in the state-by-state milk outlays, as nearly 20 percent of total milk outlays have gone to Wisconsin producers, whose production represents 13 percent of our Nation's milk supply. Alternatively, California producers have received 8 percent of the milk outlays while producing 21 percent of the Nation's milk supply.

The MILC Program has offsetting effects on producer income. On the one hand, producers benefit from the direct Government payments they receive on up to 2.4 million pounds of milk marketed when the Boston class I price falls below $16.94. On the other hand, producers are hurt as increased milk supplies caused by the MILC Program reduce milk prices. Using the FAPRI aggregate analysis of the MILC Program, Agriculture Food and Policy Center researchers at Texas A&M University suggest that until a dairy operation reaches about 600 cows, the benefits of the MILC Program exceed the loss from lower milk prices that result from the MILC Program.

The FAPRI analysis of an expanded MILC Program that covers every pound of milk produced shows that the market effects of such a program could be quite large. Milk prices could decline by over $1 per hundredweight under such a program and Government outlays could top $2.5 billion annually. The analysis of this program alternative suggest that parameters under which the MILC Program operates are critical. Perhaps even more important is the compatibility of different aspects of Federal dairy policy. The MILC Program and Price Support Program can create a chronic problem for the dairy industry if parameters of these programs are set at levels that encourage long-term surplus production of milk.

The Dairy Price Support Program has been a key component of dairy policy for many years. If the Price Support Program is eliminated, FAPRI analysis suggests that in the short run milk prices would decline by nearly 40 cents per hundredweight.

Although FAPRI analysis shows only small effects of eliminating the Price Support Program after the first two years, it is important to note that the current Price Support Program does provide a safety net in circumstances where milk supplies exceed demand needs. This can be critical in a market where demand for the product is rather inelastic.

Thank you for the opportunity address these critical issues for the dairy industry. I'll look forward to answering your questions.

[The prepared statement of Mr. Brown appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Dr. Brown. Let me also say not only does the chairman intend to begin the committee meetings on time. We will do the best we can to abide by the 5-minute rule, and I will hold myself to that. We will also call on members for questioning in the order in which they arrived. And so, we will do the best we can with that.

First of all, let me turn to the issue of market volatility. From 1995 to the present, dairy farmers have seen significant volatility. Part of the difficulty producers have faced during his period is risk management, particularly when prices have fallen below the support price in 14 of the last 39 months.

Dr. Collins, in your opinion what is causing this, and I guess more importantly, what remedies to the Price Support Program is the USDA considering at this point in time?

Mr. COLLINS. Are you asking me about volatility generally, or the fact that class III prices have been below support?

Mr. GUTKNECHT. Well actually I am asking you about both. And the question is what can we do about it?

Mr. COLLINS. Well I guess this question about the class III price being below $9.90, or the cheese price in Chicago being below our purchase price of cheese, has come up repeatedly, for many, many months. Because there have been a number of months where that has occurred. And Mr. Cropp in his comments just said that is evidence that the Price Support Program is not working. I guess I could take a different view of that. I think what the law tells us to do is to set purchase prices for products, such as cheese, in such a way that a plant of average efficiency can pay on average $9.90. The word average is in there twice. And it doesn't say anything about class III milk. It says $9.90 for milk going in to those three products, butter, powder, and nonfat dry milk. Somehow we have associated the goal of the Price Support Program to keep the class III price above $9.90. The class III price is a minimum price under Federal orders. It is not even mentioned in the Price Support statutory language.

So one thing I would look at is what are farmers receiving for milk going into manufactured products. And one way to look at that is the National Agricultural Statistics Service price of manufacturing milk, which they report. And that price every year, has been above $9.90. I think in 2000, it got down about $10.50. It is true, periodically it has fallen below $9.90. For example, 2 months ago it fell to $9.80 in the United States. But the most recent price for April is $9.90.

So I guess the first general point I would want to make is that I think we ought to be clearer about what the goal of the Price Support Program is. Is it to achieve a minimum price under Federal orders for milk going into cheese at $9.90, or is it on average to achieve a price for producers, for milk going into all manufactured products. Because class 3 is a minimum price, and we know in certain areas of the country, processors pay more than that minimum under Federal orders.

Now having defended the program vigorously here, you asked me what can we do about the price going below our support price for cheese, or below $9.90. And I think that does get into this question of if we did want to ensure cheese prices don't go below $1.13, then there are probably some things that can be done.

One of the things people have taken a hard look at is what it costs to deliver cheese to USDA, as opposed to delivering it to commercial buyers. And we impose some requirements and other things that cause the cost. There is a difference in cost by some estimates; I think National Milk did an estimate of about 5½ cents

a pound. So one thing we could do is pay producers, or pay processors for those additional costs, if we wanted to do that. Or we could change our specifications. We could change the way we pay, and we could change what we demand of the products that we buy, so that they are more similar to products in the commercial market, or the process is similar to a commercial transaction. So those are two choices right there, and I will tell you that we have been looking at that, since we received National Milk Producers Federation's cost estimates for delivering product to USDA. We are reviewing those, we are doing some of our own survey work.

I can't tell you that any action will come of that, because quite frankly, I think it is a very hard sell to go to the Office of Management and Budget and tell them we are not supporting the price of milk at $9.90, when the manufacturing price of milk is consistently there.

Mr. GUTKNECHT. My time has about expired, but let me throw out one quick question for the other group.

What risk management tools might help producers manage this volatility, and such as revenue insurance, Dairy Options Pilot Program, or forward pricing of milk? Can you comment very quickly on, Dr. Cropp?

Mr. CROPP. Sure. My report of risk management, as we all know. I can give many examples of dairy farmers in my part of the country, that had some of the best years in the dairy business the last 2 years with this volatility by using risk management tools.

There has been a combination of many of them have resorted to contracts with their milk buyers, setting in a base milk price. Others have directly used the futures, or options. And simply saying there has been an opportunity—there is a great opportunity to avoid low milk prices in 2000. A great opportunity to avoid them in 2002. In fact, the opportunity was there to set some of the best milk prices up until early of that year, if you took advantage of that.

So I think it is a tool farmers need to look at and use, it is there. I am just supplying it with the National Milk Federation, I am not supporting continuation of contracting the Pilot Program. Because I think producers ought to have the right to contract with a co-op or individual firm. I do not buy the logic, it destroys the Federal order system when plants still are obligated to the pool.

We have had contracting for 100 and some years in the grain business. I realize a small percent of farmers use that directly. But we are going to have this volatility with the support price we have that is not all bad. If we want part of this to work, we are going to have volatility. Small changes in supply and demand, these tools are very readily usable and the smaller farmers have to either rely on contracting, because they don't have the volume of milk, or futures contract. And so I think we ought to provide for milk plants to offer that. In our area there is a strong interest in doing so, and there are more and more farmers that are doing it. I can give testimony to those farmers that have done it, have done quite well by managing their own risk.

Mr. GUTKNECHT. Thank you, Dr. Cropp. My time has expired.

I'm sorry, Dr. Brown, because I will turn to the ranking member, Mr. Dooley.

Mr. DOOLEY. Thank you. Mr. Collins, I just want to run back through the numbers again. We are projected to spend $2.4 billion on the MILC Program this year. And in terms of the Purchase Program, does the USDA have the figures in terms of our outlays for the purchase of the butter, cheese and powder for this year, and what the projections will be there?

Mr. COLLINS. I don't have them in front of me. I have our baseline estimates for 2002–06, which is about $1.6 billion. I am going to guess it is somewhere in the range of $400 million or $500 million, something like that.

Mr. DOOLEY. For the purchases themselves?

Mr. COLLINS. For the purchases, correct.

Mr. DOOLEY. And then we also have, with the purchases that were powder this year, we are going to have ending inventories this year of powder of 1.3 billion projecting?

Mr. COLLINS. That is correct.

Mr. DOOLEY. And how, as I understand it, that is what 100 and almost not quite 2 years utilization in the private market?

Mr. COLLINS. That is correct, too.

Mr. DOOLEY. And how much is it costing us to store these products? Is that included in the $400 million?

Mr. COLLINS. Yes, it costs us—it cost us last year about $22 million to store what was roughly 1.2 or 1.3 billion pounds of nonfat dry milk.

Mr. DOOLEY. OK. The National Milk Producers Federation is going to testify a little later that they are not very happy about the way that you folks are running the program. And which I find a little bit remarkable, when we are spending $2.4 billion through the MILC Program. We are purchasing 10 million pounds of butter, 33 million pounds of cheese, and 600 million pounds of powder, all of which is being funded by the taxpayers, which seems that we are asking them to do a lot here. And I guess in some of our questions here where are directed on whether or not you are implementing the program in terms of the support price of $9.90, which you made, I thought a pretty compelling argument that you were.

Dr. Cropp, you said there might need to be some adjustments there, but I would be interested in terms if we did see an effective increase in the price that we are paying for these commodities. What would be the signal that we would see in the marketplace, and what would be the producer response that we would think that we would result if we were effectively paying more through the Government purchase programs for powder?

Mr. CROPP. Well like I said, your question with one comment here, I commend the Secretary for doing 2 butter powder tills. I think administering this program the Secretary is supposed to administer the program to achieve the $9.90, but have the flexibility at least twice a year to adjust, and there was a lot of resistance to that because of a different purpose, trying to hold up class I prices, rather than achieving the Price Support Program.

And to answer that question, I agree pretty much with Dr. Collins here, is that a cheese however is an increasing part of the pie. And if you are going to support the industry, you have got to look at that. Butter, powder is a shrinking part of the pie. Under Federal orders in all, you got 40-some percent as cheese, and powder

is 10 percent for example. So the majority of the dairy farmers depend upon, as for the growth in the cheese industry. So if you are going to have a support program, I simply say you need to look at, because that is where the cheese prices drops substantially below support and class III got down below $9 for awhile in 2000.

But I am not advocating a higher support price, I am advocating let markets function and work. I think the difficulty we have is we have a Price Support Program, and a Milk Income Loss Contract Program on top of it. I am not so sure that is maybe one or the other, rather than both.

Mr. DOOLEY. There have been a lot of questions about and concerns about the impacts that milk protein concentrates have on the domestic market, and the price of milk in the United States. I am struggling to understand why we don't have a domestic industry in terms of production of milk protein concentrates. There are some individuals, and that make the contention that one of the reasons is, is that we have a purchase program for powder that is at a level that does not result in a financial incentive for the investment in the capital to develop this market for milk protein concentrates. Dr. Brown, what is your assessment of that line of thinking?

Mr. BROWN. I do think that when you look at what we have in place in terms of the nonfat dry support price at 80 cents, in many cases we have retarded growth in any kind of domestic MPC industry in the U.S. It may be more cost effective to produce that product and sell it to the Government, than try to produce MPC's. Now we are seeing a new plan to come on board, the DFA has in southwest U.S. that may start to move that around, so that we are going to see some domestic MPC production occurring here in the U.S. But I think again, we are going to have to see how that plays in terms of what we have occurring with the price of our program. It may be tough to grow our domestic industry for MPC production to a large extent, given what we do have going on with the Price Support Program.

Mr. GUTKNECHT. The gentleman's time has expired.

The gentleman from Michigan, Mr. Smith.

Mr. SMITH. Mr. Chairman, thank you. As an old cow milker, that used to sell based on butter fat. What is your analysis of the component pricing now, does component pricing and the reimbursement to farmers based on the component prices represent what you get from the utilization of that milk in terms of final product? That is not a very clear question?

Mr. CROPP. No.

Mr. SMITH. Is component pricing a fair way to price milk to farmers, based on how much money the seller gets when they sell the different products that might be developed from that milk?

Mr. CROPP. I'll have at it. Yes, I think component pricing is the proper formula; we argue over the formulas. We just had a change in Federal order formulas right now. But basically, increasing share of the milk is manufacturing use, and the components in there determine the yields of those products and the value of that milk, and so it is a fair way. We want farmers to get the proper signal to produce the composition of milk that we need. So we have been in component pricing in the upper Midwest for quite a while, and in California for a long time so.

Mr. SMITH. I guess the two most important components would be protein and butter fat, I am assuming?

Mr. CROPP. Right.

Mr. SMITH. And so you are saying that however we manufacture, if it is a manufactured product, or the sale of cream or half and half, represents the kind of return that makes component pricing fair to the farmer?

Mr. CROPP. I would say absolutely, we take milk apart, put it back together.

Mr. SMITH. I have got some curiosity questions here, what is the average national production for a cow, now?

Mr. CROPP. A cow, 18,000 pounds of milk.

Mr. SMITH. 18,000 would be a national average?

Mr. CROPP. Yes, a cow.

Mr. SMITH. All right. Now let us see, our milk production went up 0.7 percent last month with these low prices, why is that?

Mr. CROPP. It wasn't because production per cow was up, I think only——

Mr. SMITH. No, no, not per cow, total milk production in the United States went up, it shot up higher than a year ago?

Mr. CROPP. Cow numbers are still higher than a year ago.

Mr. SMITH. Pardon?

Mr. CROPP. Cow numbers are higher than a year ago, more milk cows than a year ago.

Mr. SMITH. Well, why is that?

Mr. CROPP. Well for one thing, it takes a while——

Mr. SMITH. I mean with the low prices, all of my farmers complaining about low prices, and they are expanded milk production, just typical farmer reaction, if you are not making milk money, milk more cows, I think so?

Mr. CROPP. I think there is a combination of reasons, and it does vary by State. It is going down drastically, Minnesota is down greatly a 4 percent in production. Part of it is I think the different structure of dairy industry. A lot of these dairies are farmers in the prolonged haul, if milk prices recover, they are in for a long haul. So you have got to keep your bottom full once you start expanding and a bulldozer comes it takes awhile for adjustments. You have got to fill up with cows, and I think the milking loss contract we indicated has stopped the decline in the smaller part of it. For every evidence you look at, cow numbers and the decline of farm numbers, so——

Mr. SMITH. Visiting with your counterparts in New Zealand, they told me that they now control 50 percent of dairy products that are exported in the world. Would you say that is true?

Mr. CROPP. Not that high, it seems high to me.

Mr. SMITH. I see some yes, and some no's.

Mr. CROPP. Yes.

Mr. SMITH. But some place around there.

Mr. CROPP. It is high, it is high.

Mr. SMITH. But some place around there, New Zealand is building the NBC plant down in Oklahoma now, and then in New Mexico and there is the Texas Dairy Producers are building another one in Texas. What is that going to do in terms of the overall ef-

fects on milk prices, and will they survive with the price that we are paying for nonfat dry milk?

Mr. CROPP. I don't think it is going to do much on the overall effect on milk prices. Certainly not in the near term, you are talking about one or two plants that are going to produce presumably MPC's, that is a protein product, it could result in some diversion of milk away from butter powder plants. But since we have so much milk going to butter powder plants now, that we are right at support, I don't think it is going to make a big difference.

Mr. SMITH. What would be roughly over 40 percent, at least the figures I saw, it says over 40 percent of the milk comes from herds under 200 cows right now. Are we supporting those smaller herds with our Price Support Program, where every pound of milk they sell is supported with the Contract Low Price Program?

Mr. CROPP. Yes, we support the price of milk directly through the purchase of our products, and then we write a income support check to the small producers.

Mr. SMITH. And so without that program, would some of those farmers stopping production?

Mr. CROPP. I think so, even with that program, some of the farmers are stopping production.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. GUTKNECHT. The gentleman's time has expired. The chair recognizes the ranking member of the full committee, the gentleman from Texas, Mr. Stenholm.

Mr. STENHOLM. Thank you, Mr. Chairman. I have an opening statement that I would like included at the appropriate place in the record for today.

Mr. GUTKNECHT. Without objection.

Mr. STENHOLM. I would like to first commend you, Mr. Chairman, for this hearing and hope that this will be the first of many hearings in which this subcommittee takes an in-depth look at the whole question of the Federal market order system and whether or not it has served its time. When you have a situation of volatility that we have seen in milk pricing, when you see all of the criticisms that are now coming from the Dairy Program and the costs, and you still see the unprofitability of milking cows in an efficient way, we have got a problem. And I think it is time for us, all of us, and I say myself included, and as ranking member I look forward to working with you as you do so. A couple of questions. Are you familiar with the Nunes bill, Dr. Collins?

Mr. COLLINS. I have read it, yes.

Mr. STENHOLM. One of the problems we have now, and when the bill first came up, I had some problems with it because of unintended consequences, that might occur. And so often when we try to fix a specific problem, instead of a rifle shot, we get a shotgun, and it hits a lot of unintended consequences. However, I have been convinced by my colleagues on this committee, principally Mr. Nunes, and Mr. Cardoza, that action is necessary in order to avoid the risk of severe disruption in the California marketplace. Rather interesting that we need to legislate in regard to a single facility, that to me is a symptom of a deeper problem. Even more so, when we find that there is another handler in Clark County, Nevada exempt from milk pricing regulations that apply throughout the rest

of the order system. Again, one rifle shot, again obviously for a specific purpose. My question is when we talk about this nonfat dry milk, and all the costs of storage, and all of this and your answer regarding whether or not the Department has done everything it should have done under the law, which we will hear later. Where is the powder coming from? Does it come from all over the United States? And all of the orders in an equal manner, or is more of it concentrated in certain areas?

Mr. COLLINS. The powder we are buying mostly comes from the West, California.

Mr. STENHOLM. Most of the powder comes from the West. Not interestingly, that is the one State that has chosen not to participate in the Federal market order system. And we have debated this for the 24½ years I have been in this Congress. I think it is fascinating, that at the same time that we have criticism of the costs, we find that somehow, someway, either in the administration of, or in the fault of the legislation that, that is creating a problem.

This whole area too, I remember when we used to have butter out the gazoo, and the industry absolutely didn't want to make any changes in the price of butter et cetera. And then we lowered the price of butter, and lo and behold, consumers began to buy more butter, and we had a problem, we allowed the market to warden. And it worked.

Now I don't think we are ever going to get there, Mr. Chairman. I don't think we are ever going to get there, as long as we keep trying to defend something, that is not working. And I would hope that the industry is well represented, as you are and one of the things that has bugged me, in an industry that is 85 percent cooperatively owned, which means its owned by, as we used to say in the electric co-op, it is owned by those we serve. That we continue to allow a 2 percent surplus, i.e. inventory blessing, to be as destructive of pricing as we see it today.

Dr. Collins, when you testified that we are at a 25 year low in milk prices, that's not demonstrated in the excellent products that we have. Something is wrong with the whole system. And Mr. Chairman, I hope and I look forward to working with you, and Mr. Dooley, as we look at kind of thinking outside of the box, and seeing if there is not a better solution for our dairymen, than what we are operating under today.

But on the Nunes bill, you do not have a position on that?

Mr. COLLINS. No, the Department has not taken a position yet. We are reviewing it.

Mr. STENHOLM. You will review it, you will allow this committee the benefit of your views, before we bring it to the floor?

Mr. COLLINS. We have been asked to review it, and we will have a position on it.

Mr. STENHOLM. Thank you, sir.

Mr. GUTKNECHT. The gentleman from Montana, Mr. Rehberg.

Mr. REHBERG. Thank you, Mr. Chairman. And let me add my accolades to you as chairman for calling this meeting.

I am struck by the comments of Mr. Stenholm that are similar that I have, he has been here 24½ years, I have been here 24-plus months, and we have come to the same conclusion, this is one of those industries that a lot of experiments have been tried over the

years, and it is time to look at some of the things that have worked and not worked.

I was relaying a story to the chairman about my background of how I got into politics. My great grandfather helped create the Milk Control Board in Montana, my grandfather served on it and my dad sued them. And the end of the story was as Lieutenant Governor, Governor Mark Roscoe and I, eliminated them. It took four generations to realize that it was a mistake to begin with. I hope I am a quicker study than you, Mr. Stenholm, and it doesn't take me 24½ years.

I would like to review a couple of policies within the milk industry that have occurred over the years that are still under my saddle a bit. Let me use the dairy buyout as an example. I just happened to be in the cattle business at the time, and a lot of my friends went out of business. We are in the cattle business as a result. Dr. Collins, I would like to know, in your opinion, did the dairy buyout work? Did it accomplish the goals that it was intended, and the disadvantage that you are at, is there is going to be a presentation I understand from the testimony later on, to once again suggest perhaps another buyout. Let us forget for a minute who is going to pay for it. And going back to Mr. Stenholm's comments about unintended consequences. That was one of them, did it work, and does the administration support doing this again?

Mr. COLLINS. Well some aspects of it worked, and some didn't. What worked is that it did reduce milk production for a number of years, below what it probably otherwise would have been. Where it was problematic was that it didn't deal very effectively, with all of the beef that was produced from all of the slaughtered dairy cows, so it had a consequence for cattle markets, which you are referring to. Nor, was it a permanent way to balance supply and demand in milk markets. It was an attempt to avoid further reductions in the support price. The support price reductions would have been a more permanent approach to balancing supply and demand. But by doing a whole herd buyout, or termination program, ultimately over time, with prices being boosted by the reduction in production, you get more capital coming in to milk production. Either the producers that return 5 years later, or those still in the industry, expand. So it was a temporary fix, not a permanent fix, and it did have market repercussions for beef.

Mr. REHBERG. So then the follow-up question is, is this the time for another temporary fix, or is that one of those ideas that has come and gone, and ought to be left on the table?

Mr. COLLINS. Well I am speaking from an economic point of view, I am not a fan of temporary fixes. We have had on the crop side, 70 years of those things with supply control and diversion programs, and we finally shut those down with the 1996 farm bill. Now I think those things were mandates. They were attempts to maintain a certain Government support structure with temporary fixes, to relieve temporary imbalances.

Mr. REHBERG. One of the reasons why dad sued the Milk Control Board is he said he could produce a better quality product, at a cheaper price than they were allowing him to charge, and he didn't have the capital necessary to put together to compete with the big

guys and couldn't stay small, so he was stuck in the middle of it, pretty well put him out of business.

One of the things we do in agriculture is continually try and find ways to create cooperatives, and have those cooperatives work together. Do you think the Federation's Cooperative working together can work, and in the long-term is it any more legal than any other opportunity to create strength in the marketplace?

Mr. COLLINS. Oh you would really like me to answer that. I think that you know, if they get a high enough participation, they could have a voluntary program that producers could pay into, and they could undertake some of the export and domestic supply control programs that they have envisioned. Again, I think those things are temporary, and if there is a fundamental imbalance because productivity in dairying is increasing faster than the growth in use, then over time, milk prices adjusted for inflation are going to continue to decline, and this is not going to solve the long-term problem. On the other hand, if people think that markets are going to be different in the future and there is no need to wash people out of dairying now who might otherwise be able to prosper in years to come, then you undertake these short-term temporary measures. I think the history in all of our agriculture commodity markets has been pretty generally that the long-term trend has been declining real prices, high productivity growth and adjustment over time in our support structure to bring the industry more in line with the market.

Mr. REHBERG. Thank you, Mr. Chairman.

Mr. GUTKNECHT. The gentleman's time has expired. The gentleman from Minnesota, Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman, and thanks for your leadership. I hope that you and the ranking member, Mr. Dooley, and this committee can fix this problem. I served as ranking member for 8 years, and I don't know if we did much good, it probably got worse, it seems like. But we wish you well, and I think it is a good thing to have this hearing.

My first question is, well I think you all kind of testified that the MPC is a problem, but it is not a significant impact on the price. They are working on this Free Trade Agreement with Australia, and it sounds like if they get it done, it will go to New Zealand as well. What impact would be on the industry if we ended up with a Free Trade Agreement with Australia and New Zealand with no duties, and no restrictions on imports of any kind of milk products? Have you thought about that? Anyone of you.

Mr. BROWN. Well I think looking at Free Trade with Australia, and potentially New Zealand, we definitely run into a situation where we will talk about additional dairy products that are going to come into the U.S., and in some cases some of those products we are going to have to worry about the Price Support Program, and what levels we have set at because we may see product that will displace some commercial production that we have occurring here. So that is one thing that we will have to worry about. I do think that by and large, as we look at where world dairy prices are today, relative to U.S. prices, in many cases we are going to talk about additional products that will come in. The Australians, New Zealand would rather sell into some higher priced U.S. markets,

than some of the world alternatives that they normally have. So I think in that case as well, we will see other markets that potentially will lower U.S. domestic products, product pricing that we see occurring.

Mr. PETERSON. Has anybody done any studies as to how much impact this might have, has there been any kind of economic?

Mr. COLLINS. I have not done one, but I would agree with Dr. Brown, the degree of disruption, can be measured by the price gap between our domestic prices and the world price. And if you look at the last few years, our butter prices have been twice the world price, and our powder and cheese prices have been 40 to 50 percent higher than the world price. And so that would be like a magnet to bring in other products.

Mr. PETERSON. Are any of you going to study this and give us an analysis of what might happen, because this might actually happen, and we may not be confronted with?

Mr. COLLINS. The Department of Agriculture is doing a study of a potential Australian-U.S. Free Trade Agreement, yes.

Mr. PETERSON. OK. The other thing I have been looking at these production. And Minnesota has been going down more than just about any other place, and Michigan has been going up, and so I asked Representative Smith why that was, and one of the anecdotal things he said was that they had Dutch farmers, and Canadian farmers selling their quota and moving into Michigan. Now in Minnesota, that is illegal. I think it is illegal, am I right Commissioner? They tried to change it in the legislature, but I don't think they did. But my question is has anybody looked at this, how many people are actually doing this, selling quota in the Netherlands, and in Canada and moving into the United States? Is it just a few producers, or is this kind of a big deal that is going on? Does anybody know?

Mr. COLLINS. I have no data on that, I haven't a clue.

Mr. CROPP. I don't either, I would say though, it is a relatively small number, there has been some of that, there has also been people from Holland. Some of them were coming here. In Minnesota you don't allow that, and I realize kind of change the law, because maybe you need some of that.

Mr. PETERSON. Right.

Mr. CROPP. And steal your dairy industry, but that would be a small part of it. I think the difference is, is basically Michigan, even eastern Wisconsin, has been more progressive and modernized in their dairy industry, lower their cost production, other areas a lot of smaller farms, old facilities and haven't made that change. And we have got a lot of exiting, and not the new investment coming in and there is a number of reasons for that. But we need to look at that as a new investment.

Mr. PETERSON. Is there anyway to find out how much of this is going on? Mr. Collins, is there anyway that you can track this to let us know how many people are coming in from the European Union or from Canada that is selling their quota and using that? As I understand it a 50 cow dairy in Canada is worth about 2 million bucks.

Mr. COLLINS. We have immense data bases at USDA, but I can't get an answer to the question of how many dairy operations par-

ticipate in the MILC Program, let alone find out how many people are coming in from foreign countries.

Mr. REHBERG. Well maybe the Homeland Security can help us with that. That is if the gentleman would yield, Green Peace in Michigan keeps track of them very well.

Mr. PETERSON. Well maybe you can give me a report then. Thank you, Mr. Chairman, I appreciate again your leadership.

Mr. GUTKNECHT. The gentleman yields back the balance of his time. The gentleman from South Dakota, Mr. Janklow.

Mr. JANKLOW. Thank you very much. I believe in Europe and some of the countries like Holland, some will carry a $25,000 certificate don't they? I mean the value of the certificate is worth about $25,000, isn't it, Mr. Collins?

Mr. COLLINS. I don't know what it is valued, but normally in countries that have quota production program, the quota takes on a value, and in Europe they do have a quota program.

Mr. JANKLOW. I think they are worth about $25,000, and you can sell them for that and come over to this country and start a large scale operation for $4,000 to $5,000 per cow. And so they are worth about 5 to 1 in terms of cows, for the Europeans to sell those certificates, at least that is the familiarity I have with those programs. I am a little bit struck by some of the statistics, in the testimony. It appears that the larger operations, have had a substantial increase, and the herds above 500 have increased substantially over the last several years. But it also indicates that the amount of productivity that they have, has increased far greater than the smaller herds in the country. I am trying to grab the testimony from one of you gentleman that has that laid out. But what I was wondering was, what is it about the smaller herds that makes them less productive per cow? It is on page 3 of Mr. Collins' testimony.

Mr. COLLINS. As a general reaction to that, I would only say that that probably focuses on the knowledge, skills and abilities of the farm manager. And sometimes those who have high skill, high knowledge, high abilities and are aggressive, want to get larger. Those that are smaller sometimes have less ability to manage their animals.

Mr. JANKLOW. Well looking at the testimony and listening to the testimony of all three of you gentlemen, and reading your testimony and being aware just generally, of what is going on in the marketplace. It appears that the output per cow has gone up about 2 percent over the last few years. The number of cows have increased, the amount we are paying out in total amount for support of our programs has increased substantially. The price of milk has gone down substantially. Can any of you tell me what is it about this that isn't a typical marketplace problem, where over supply is driving down the price, especially in the face of the international markets?

Mr. COLLINS. It is a typical supply and demand problem.

Mr. JANKLOW. Is there anything we can do to fix it other than write bigger checks, which would raise the number of livestock? I do believe when they had the Dairy Buyout Program years ago, in addition to dumping meat into the beef market, which created a

distortion, it also made some people very wealthy, buying cows and leasing them to dairy farmers.

Mr. COLLINS. All right, if your question is, is there anything we can do to fix it, what we described was a normal supply and demand problem. And you are asking, how do we fix a normal supply and demand problem?

Mr. JANKLOW. You get rid of the supply or increase the demand.

Mr. COLLINS. Well you intervene and you prevent a normal market adjustment from taking place. And I mean, that is what we typically do. Whether that is a prudent thing to do or not is what we have a continual debate about.

Mr. JANKLOW. Well let me ask you a question out of ignorance, if I can, sir.

Mr. COLLINS. Sure.

Mr. JANKLOW. If we have a 2 percent surplus that we are just banking away, putting away. Why don't we just give it away to hungry people in Africa, just give it to them, and pay for the shipping, and let them worry about distributing it and give them 3 percent, not 2. Wouldn't that raise our price substantially, and save our Government a couple of billion bucks?

Mr. COLLINS. We do try and give away all that we can give away. As we noted earlier, we are now sitting on 1.3 billion pounds of nonfat dry milk. We would love to give that away. However, there are limitations on what is considered bona fide humanitarian assistance. And so in a good year, we can legitimately give away maybe 80, 90, 100, 120,000 tons of nonfat dry milk, which only makes a small dent in our inventory. So there are limitations without creating disruption for the market.

Mr. JANKLOW. What are the limitations?

Mr. COLLINS. We have international obligations to make our humanitarian assistance legitimate. If it is not legitimate, then it is an export subsidy, and it contravenes our WTO export subsidy obligations.

Mr. JANKLOW. Are we going to have another round, Mr. Chairman?

Mr. GUTKNECHT. I don't think we are going to have time. We have three panels. There are three or four questions that I want to ask this panel myself. And so I would ask if you would be willing to respond to some written questions, not only from the Chair, but from other members of the committee. And they are all nodding affirmatively, for the record. So next we will go to the gentleman from California, Mr. Cardoza.

Mr. CARDOZA. Thank you, Mr. Chairman. Mr. Collins, I am interested in what percentage of U.S. consumption do imports constitute?

Mr. COLLINS. A tiny amount, 1 to 2 percent.

Mr. CARDOZA. I have heard numbers as close as 10 percent.

Mr. COLLINS. I don't—that seems awfully high to me. I guess it depends on how you're measuring it, whether it is milk fat or solids.

Mr. CROPP. I think cheese is 6, 7 percent or something like that on the cheese part, but——

Mr. COLLINS. Well then I stand corrected, it is higher than I recollected.

Mr. CARDOZA. Because I have been told and I need to find out this information, it is important to me. I have been told that if there were no imports coming into this country, that domestic supply would be less than the domestic demand.

Mr. COLLINS. I think they would be in pretty close balance, because we also export as well. Now if we are not having any imports, would we continue with our exports, we might not.

Mr. CARDOZA. I am not the expert, sir.

Mr. COLLINS. I don't know.

Mr. CROPP. Gentlemen, if you put out numbers on milk equivalent basis, it shows that we have a shortage of milk. Well that is an accounting type of thing. If you eat a pound of butter weighing 2 pounds of milk, but really didn't because we are buying a lot of powder. I guess the point I make with the support program we have, that markets are going to clear. And right now, productions look greater than consumption, so prices are depressed. In 2001 we had reversed, prices were record high, it is very sensitive to small changes. Cows are milked everyday, and that milk has got to move through the system, so markets will clear, and so it is going to balance out. So if we reduced imports, yes prices improve, production will respond, then we are back to the same place we are right now, so——

Mr. CARDOZA. Well there is contention from my part of the world, where I come from, that milk protein concentrates and other imbalances have been caused by getting around trade tariff issues and some other things, and so when you talk about small shifts causing big problems, I am concerned about that.

Mr. COLLINS. But let me go back and just make sure I have the record correct. I said imports were small and said I stood corrected. I go back to where I stood in the first place. For 2002 to 2003, imports were 5.1 billion pounds, our total production is 170 billion pounds. Imports are small. But it is true, as Mr. Cropp said, that small changes on the margin, when you have very inelastic demand, very inelastic supply, that is they don't respond much to price changes, can cause very big shocks. And that is the allegation, that imports, particularly the protein concentrate imports, have created on the margin, a reduction in price. But we have addressed that earlier in this testimony, and I think it is Mr. Cropp's conclusion, and I share that, that the effect of those milk protein concentrates and caseinates has had a fairly minimal effect on price, in the current environment we are in.

Mr. CARDOZA. Sir, have you looked at the effect of retail market consolidation on the pricing mechanisms? Recently surveys show that even though we have historically low prices to producers, if you go to the grocery stores, oftentimes you find that we have fairly high prices, in fact, one recent survey showed that costs go in my area, it was $2.09 a gallon, but yet, many of the retail grocery chains, were in the $3.50 range. And so we don't see the prices at the store level following the wholesale prices.

Mr. COLLINS. I think that is true in many instances. It is symptomatic of most agricultural commodity markets, there are substantial lags sometimes between the farm level prices and the retail prices for lots, and lots of reasons. Contractual arrangements, desires by retailers to hold their prices steady, also we have measure-

ment problems and whether we can actually measure the amount of product that is moving at the various prices, susch as a loss leader.

Mr. CARDOZA. Thank you, sir. I have one further question, I would like to get in before my time is up. And that is, with regard to Iraq, would that be a legitimate place for us to send our powder supply, countries like Iraq, Afghanistan, where we have people who are starving?

Mr. COLLINS. I think that is a legitimate place, and we have said that we would make available all of the nonfat dry milk that Iraq would be willing to take.

Mr. CARDOZA. Thank you, sir.

Mr. GUTKNECHT. With apologies to the gentleman from California, the staff does a wonderful job, and I just got out of order. The author of the Nunes Act, to Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. I will keep my question real simple for the entire panel, because we only have 5 minutes. So I would like for you all to comment on this new proposed herd buyout that the producers are talking about enacting themselves, without Federal Government support, and what that might possibly do to milk prices short-term, long-term. Basically, I would just like to get your comments and reactions to the program. Maybe we will start with on my left, Dr. Collins.

Mr. COLLINS. Well I don't exactly know what they are going to do when they get this program up and running. But I do think that if they are successful, and they can subsidize some exports, and they can divert some production, and maybe kill a few herds, they can raise the price of milk. And it would be a short to medium term effect. How much—National Milk has done some estimates, and I have no particular reason at this point, to quibble with their estimates, not really understanding how this program is going to operate.

Mr. CROPP. Well say, commend the co-op is trying to do something voluntarily, I think they want to get 80 percent of the production by the co-ops participate. That of course, depends upon the producers participation of those co-ops. But anything that reduces the milk supply, will have an impact. And the more the participation, the greater the impact. So take cows out of production, it has got export subsidy, it would have an impact. Concern of a free writer problem, those type of things, in the long run it is not a permanent fix, but short run we have go to reduce this production somewhat, and it would have an impact. The greater the participation, the greater the impact.

Mr. BROWN. We will need to know the exact parameters of whatever program they put in place to really do a very good job of estimating the impacts on the industry. But as the other witnesses have suggested, I think if they are successful in getting rid of cows and exporting some product, there is no question that prices will rise in the short-term. I think we need to recognize that longer term, markets will adjust to now, what has been this temporary policy that we have in place. And once we get the increase in prices, we will have other producers that will respond with additional supplies of milk. On the longer term, impact of a program like this probably sends us back to where we would have been in

absence of it. So there is very different short and long run impacts of these kinds of programs.

Mr. NUNES. Are you all familiar with the California solids standards, in the State order? I would like to get your opinion on what would happen if those standards were made Federal standards? We will start on my right this time, how is that?

Mr. BROWN. Good, I get to be the first one this time. I do think if we were to adopt California's standards across the country, we are talking about being able to use some additional solids that might probably be ending up in powder support right now. Whether or not we can talk about moving prices up significantly, again, when we talk about the fact that we have 1.3 billion pounds of nonfat dry in CCC inventory right now. That is a lot of product that we have to worry about getting rid of before we see prices probably moving up significantly. Perhaps the Secretary wouldn't release powder immediately, once we started climbing significantly above support, but at some point in time, that product has to be dealt with in some fashion. And so that may put some limit at least on the short-term of what kind of price increase we could get.

Mr. CROPP. A quick comment. Surely you would use up more nonfat dry milk. There is no clear evidence that it would improve the consumption of fluid milk. If you look at trends in California, I don't think it is any better than the National average, so there are concerns there. I would also raise the issue if you raise that price of that milk protein, what does that do to attract the imports MPC, and I mean, is that an area we should concentrate on? So I think there are some real questions of long-term depth benefit to the whole industry by doing so.

Mr. COLLINS. I would simply agree with my two predecessors. I don't think I have much more to add to that. We have done a study on this, which I can make available to you, and the farm bill does mandate that we do another study on milk standards, which we are doing right now. But I would generally agree with the statements made.

Mr. NUNES. I am not familiar with the science on, and I know there is some, the USDA has been conducting some studies or funding some studies in regard to turning milk powder into milk protein concentrate. Do any of you have a background on that process that you could comment on?

Mr. COLLINS. I do not, not scientifically. From talking with people in the industry, it doesn't seem like a prudent way to go. You would think you would go from fluid milk to milk protein concentrates, not from nonfat dry milk, to milk protein concentrates. We did look at one point, about the prospect of making some of our nonfat dry milk available for those such things. We do have a program where we sell nonfat dry milk for casein production. And I believe that has been a mandate since 1985, that we are supposed to sell a million and a half pounds a year. And most years we have sold none, because nobody wanted any to make casein. We actually sold, I think a million and a half, or 2 million pounds this past year for that purpose. So there is a tiny amount of that going on, but it doesn't seem like the economic way to make protein concentrates. It seems like the most economically efficient way, would be to go from the milk, to the protein concentrates.

Mr. NUNES. Thank you. Thank you, Mr. Chairman.

Mr. GUTKNECHT. The gentleman's time has expired. The gentleman from Pennsylvania, Mr. Holden.

Mr. HOLDEN. Thank you, Mr. Chairman. I have no questions for this panel, but I have an opening statement I would like to submit for the record. Thank you.

[The prepared statement follows:]

PREPARED STATEMENT OF HON. TIM HOLDEN, A RPRESENTATIVE IN CONGRESS FROM THE COMMONWEALTH OF PENNSYLVANIA

I would like to thank Mr. Gutneckt for holding this hearing today. As a representative from a leading dairy State, I have heard from many in the industry about the current crisis. Hopefully, after today, we will better understand the situation and can work to prevent a further decline in prices.

The structure of dairy farms has taken a dramatic shift over the past decade. We are witnessing fewer, larger dairy operations in the West, a decline in the South, and stagnation in the Northeast. My biggest concern and hurdle has been how to stabilize and keep small dairy operations in business.

Prices took a dive at the end of 2001 and have never recovered. During consideration of the farm bill conference we came to an agreement to include a counter—cyclical milk program targeted to small operations—the intent and objective was to come to the aid of small producers and help them continue. I think many producers are still in business today because of this safety net.

The nature of MILC helps farmers during times of low prices—unfortunately that's all we have witnessed. As stated before, the program has been working for a number of small dairy farmers; however, some producers are frustrated by limitations and misinterpretations of the program. I am deeply concerned about some of the guidelines established by USDA regarding the definitions and also concerned that the distribution of payments are not equitable across the Nation. Hopefully, the economists can help us understand how the program is progressing, especially due to the unexpected cost.

Since implementation, payments have gone out every month. In April the payment was $1.82 a hundredweight, March was $1.74 a hundredweight—at these levels USDA is spending about $100 million per month! This is a lot more then we ever expected and the program is supposed to be $2 billion for 3 years!

The questions of when will prices turn around and what or should we do for the industry are important now more than ever, but in order to answer those questions we all need to keep an open mind and explore all possibilities.

I understand National Milk has been working on a voluntary proposal and hopefully we can hear a little more about what they are doing as well as others.

Overall and as a nation, we are experiencing economic difficulties and financial hardships across the board. Consumer confidence is down and growth has been extremely slow. We need to help increase a demand that's just not there and it's going to take all of us working together to develop an effective solution.

I look forward to hearing from both panels and hope we can shed some light on the current situation.

Mr. GUTKNECHT. The gentleman from Iowa, Mr. King.

Mr. KING. Thank you, Mr. Chairman. I think in lieu of my questions, I would ask unanimous consent to yield to Mr. Janklow, so he could complete his line of questioning.

Mr. GUTKNECHT. Without objection. The gentleman from South Dakota is recognized for 5 minutes.

Mr. JANKLOW. Thank you. And I will just use a couple of seconds and yield the time back. Let me ask you if I can again, Mr. Collins. I will ask in a different way. I don't understand the limitations on charity in the foreign markets. I realize that is not an answer on anything, but I am puzzled when you say we are limited. Is it by the amount, by transportation facilities, distribution facilities? It clearly can't be the hunger of human beings in places like Africa?

Mr. COLLINS. It is not. And maybe I didn't give the best answer possible on that. There is no limitation on legitimate humanitarian

assistance. The only area we get into, and it is not a problem that we have, is a subsidy problem that some exporting countries have, and we watch other exporting countries as well. The problem you get into is are exporters going beyond legitimate humanitarian assistance, using the name humanitarian assistance, as an outlet for their surplus products to essentially benefit their domestic producers. And in so doing, they can displace legitimate commercial sales of competing export countries. So that is the only constraint we have got.

Mr. JANKLOW. I understand, but when you look in places like Somalia or like Saab or like Botswana, I mean the list is endless.

Mr. COLLINS. Right. For some of these, I think there are opportunities there. We try to avail ourselves to those opportunities. We will probably do so as we acquire butter and cheese now this year. We certainly have been doing it through our nonfat dry milk distribution programs over the last couple of years. We have found some countries have preferred not to take nonfat dry milk, they have preferred whole milk powder which they can get from other sources. But our Foreign Agricultural Service has had a lot of pressure on them, put on by the Secretary, to try and use every avenue to dispose of our surplus nonfat dry milk.

Mr. JANKLOW. Thank you very much. I yield back the time. Thank you, Mr. King.

Mr. GUTKNECHT. Mr. King.

Mr. KING. Thank you, Mr. Chairman. I just have once conceptual question here that is rolling around in my mind as I listen to this testimony. And maybe this isn't the panel that has the expertise, but it has come to me that there has been through embryonic transplant or transfer, a significant improvement in the amount of butter fat that has been able to yield on a per cow basis. And it has been a—it is an opportunity for the ice cream industry certainly, and if that is taken to its logical extension to where we would improve that percentage, and I think it is incrementally by 1 or 2 percent. How might that echo across the industry, how could that effect our markets in the entirety of the milk production?

Mr. CROPP. Well if you are talking about the composition of milk, actually the composition hasn't changed that drastically over the years. It stayed pretty constant, butterfat 3.6, 3.7, or crew protein about 3.1. The increase has been in pounds, simply because cows are producing more hundredweights of milk. And there is some geographical difference there, there is more in for certain areas going to the colored pries, like Jersey. Increased composition because the milk goes in a manufactured products. That is where the growth has been, manufacturing. And the higher the composition, the greater yield, per hundredweight of milk. But percentage wise, it hasn't changed a great deal.

Mr. KING. But if we are able to increase that percentage, say by 1 percent or 2 percent, go up to say 5 for example, how might that change the—if the composition changes, and it is available on a broader scale, how might that change the industry in its entirety?

Mr. CROPP. Well it would change the efficiency of making certain products, because the yield would be higher. You just come back to the same thing again, we need so many pounds of butter, cheese, to clear the market. And if you got more per hundredweight, it

would take fewer hundredweight, which means we would have to have an adjustment down through the market. But clear, it would make the industry more efficient, because that is the intent of component pricing is to have producers feed, breed, for the composition of milk that serves the market needs.

Mr. COLLINS. The support price for butter is $1.05 a pound. The market price is roughly $1.09. It suggests to me that the market price would be $1.05 a pound. And we would be buying a lot more butter.

Mr. KING. But then also it would boil down to is those producers who first had access to the technology then, would be like they are in any other industry on the cutting edge, they will take advantage of that, until such time as the market were to make those adjustments.

Mr. COLLINS. Sure.

Mr. KING. Thank you very much. Thank you, Mr. Chairman.

Mr. GUTKNECHT. The gentleman from California.

Mr. BACA. Thank you very much, Mr. Chairman. Dr. Brown and Dr. Cropp, you testified that milk production concentration imports have some impact on domestic milk prices. That impact is small. What do you estimate the increase in milk prices would be if order control such as those included in H.R. 1160 were adopted?

Mr. CROPP. Basically to stop imports, is that what you are saying then?

Mr. BACA. Yes.

Mr. CROPP. Well again, very little I guess. I think the price response has been predominantly domestic supply and demand. We actually on a total solids basis, exported more products than we imported. If we stop imports, it doesn't mean that we entirely would increase the consumption correspondingly domestically, because some of those products we are not necessarily producing ourselves. But I can't give you an exact dollar figure, it is about 4 percent of our production imported or something like that, but again in the short run, yeah you would get an increase, long run we will end up in the same place, as production responds, things adjust domestically. So it would be a short-term thing, and I don't think that would be realistic to even think about closing off imports, because we also want to expand exports.

Mr. BACA. Dr. Brown, do you want to?

Mr. BROWN. Yes, I would agree with Dr. Cropp as well, I think if we looked at closing off imports again, we do have market effects, we know that an erection of those to give you an exact change, I don't think we have done that work at this point. But it is a short run effect, and as you look at allowing markets to adjust, we will head back to a some worse place than we would have been otherwise.

Mr. BACA. Thank you. Then as a follow-up, what do we estimate is the Federal cost for higher CCC purchase of nonfat dry milk, that was displaced from the market due to the MPCs?

Mr. CROPP. The point I might make is that I cited in my paper, my colleague justly did some pretty extensive balances of last year, of what percent of nonfat dry milk possibly could have been displaced. And being somewhat generous an estimate, somewhere between 300 to 400 million pounds. I think if that cause is semi-right,

we bought about 800 million, or a little more than 800 million pounds of nonfat dry milk. So we still would have a surplus, nonfat dry milk would still have been a substantial purchase and growing. So the Support Program isolated the impact on our milk prices what we are saying, but it did add to the cost.

Mr. COLLINS. I agree with that, but I would not agree with that displacement estimate. That is, I don't have my own estimate, but that study shows the displacement greater in the year 2002 than it was in 2000, when we had the all time record high imports. It is an artifact of the way the displacement estimate was made, and I think it is an over estimate. I think the effect is smaller, but surely there is some displacement, considerable displacement, by MPCs and nonfat dry milk. Because in many uses, there are substitutes. But in many users they are not substitutes. And if you didn't have the MPCs, then something else would happen. You might find those end uses looking for something to make their product out of. It might not be milk, it might be soy protein, or it might be any number of other things. So if there is not perfect substitution for every end product between nonfat dry milk and MPCs. But I do agree that the displacement is probably a couple hundred million pounds anyway.

Mr. BACA. Well that is why we are very much concerned with the economic conditions or the damage it could have on us, as well as we look at the imports, so it could have some there.

The next question that I have is pending the Agriculture Committee at this time, is a bill on, of course, Nunes has an H.R. 1659, which is designed to ensure that fluid milk bottlers situated in Arizona are not able to avoid—or are able to avoid price regulation by selling across State borders to California. For USDA is the Department aware of this situation that has led to the introduction of this bill? That is question No. 1, and has the Department either considered, or been asked to consider taking regulatory actions regard to this situation?

Mr. COLLINS. The Department is aware of that bill. We have also been asked to take regulatory action, with respect to at least part of that bill, that is, limiting producer handlers, who have essentially been exempt, who are exempt, from Federal Marketing Order Regulation. We have an issue now, I think it is the Arizona, Las Vegas order to look at that question of regulating producer handlers above a certain size. Regarding regulating handlers in an order, where they don't sell into that order, that is not something we have ever done. And that is what that bill would have us do. It may be a prudent thing to do, the Department will opine on that at some point. But it would be precedential, it would be having us deviate from our long standing regulation, where we regulate a handler in an order where they have the majority of the sales of their product. Now we would be regulating someone under one order, who is competing in a different order, where the competitive conditions would be very different, than in the order in which we would be regulating them. So I think it is just something, that we have to think carefully about.

Mr. BACA. OK. Thank you very much, Mr. Chairman. I know that my time has expired, but I also have a opening statement that I would like to submit for the record today, as well.

Mr. GUTKNECHT. Without objection. As I mentioned, some of us have additional questions and we would certainly like to send them to you. And we would hope that you could respond as quickly as possible. Especially, as it relates to this whole issue of milk protein concentrate, and the displacement issue, as they are really incredibly different views out there in the dairy industry, of exactly what the impact and what is happening with milk protein concentrate. We have got a third panel, where we may learn a little more about that issue. But I will dismiss you and thank you for coming for the subcommittee today, all of you. And call up the next panel of witnesses.

We expect a series of three votes around 12:30. Which will mean if we don't finish with the second and third panels, we will have to recess the subcommittee and come back to finish that up. And we hope that most of you will be able to come back. We understand that there are an awful lot of things going on today.

This second panel, Mr. Jerry Kozak is the president and CEO of the National Milk Producers Federation. And Mrs. Connie Tipton, is the executive vice president of the International Dairy Foods Association. And I do want to thank the IDFA, because they have provided members with a variety of the world's finest beverage in various flavors, and we are enjoying the milk today. And one of the things that I hope to do for the benefit of the members is, it has been brought to my attention, and I am keenly aware of the fact that, we here in the Capitol complex do not have enough vending machines that sell milk. And so I will be sending a letter in the next several days to the Committee on Administration, suggesting that we have more milk vending machines here in the Capitol. And I would appreciate it, if any of you would be willing to co-sign that letter. With that, Mr. Kozak, welcome to the committee and we invite your testimony.

STATEMENT OF JERRY KOZAK, PRESIDENT AND CEO, NATIONAL MILK PRODUCERS FEDERATION, ARLINGTON, VA

Mr. KOZAK. Good morning, Chairman Gutknecht, Ranking Member Dooley, and the other members of this subcommittee. I am Jerry Kozak, the president and chief executive officer of the National Milk Producers Federation.

Mr. Chairman, I won't sugarcoat the point that I am going to make today. The state of the U.S. dairy producer community is deplorable. A few weeks ago, the USDA announced that the April all milk price is $10.90 per hundredweight, that is the lowest level it has been since 1978.

In the brief time you have allotted me this morning, I can't possibly go into every factor behind depression in dairy farming. My contribution here is not to take issue with USDA's explanations, but it is to take issue with the Department itself, and how it has mishandled the management of many dairy policies that are intended to help producers. The programs we have in place, many of them created by Congress are fine. But the way they have been administered lately, is anything but fine. The USDA has had many chances to be part of the solution, but for whatever reason, they remain part of the problem. These programs are tools, that if used

properly, could do a great deal of good. But these tools are being used inadequately at best. Let me list five examples.

First, the outcome of the 2002 farm bill. Our No. 1 objective was the extension of the Dairy Price Support Program. It is dairy's best safety net; no other program gives producers more bang for their buck. But USDA is not operating the Price Support Program in a way that is supportive of dairy farmers.

The law that Congress passed stipulates that the USDA should provide a modest price floor level of $9.90 per hundredweight for producer milk prices by offering to purchase cheese, butter and skim milk powders at levels that will return $9.90 to producers. Chart No. 1 illustrates the prices for class III and IV, during the past 12 months. Clearly, the program is not living up to its obligations, particularly in class III.

We believe that the Department is failing in its statutory obligation to maintain purchase levels for butter powder, and especially cheese, that allow the average plant to return $9.90 milk support price to farmers. NMPF did an extensive survey within its membership, of the additional cost of selling product to the CCC. Based on that survey data, we offered the Department specific recommendations to address this problem, and have received no response.

Compounding the problem has been the way the USDA has devastated dairy producer income, by adjusting the price support purchase "tilt" between butter and powder. The USDA has reduced its offering price for nonfat dry milk by 20 percent since May 2001. Rather than saving money through these reductions, the agency has created a "lose-lose" situation. As chart No. 2–A describes, the tilts have cost dairy farmers nearly $1.5 billion in lower prices. What's worse, we project that the tilts have a continued detrimental impact on prices in the range of $2.4 billion through the end of the year.

But as chart No. 2–B shows, the tilts have also cost USDA an additional $56 million, in higher net expenditures. Sure, while the CCC purchases have been reduced only slightly, because the tilt raises butter's support level as it drops the powder price, USDA is now buying butter, more than 10 million pounds to date. The cost of these butter purchases, plus the higher cost of the milk payments, quickly overwhelmed the savings on nonfat dry milk purchases. And because both tilts have reduced farmer prices, the cost of the Government's MILC Program has also jumped.

So let me be clear: USDA's mismanagement of the Price Support Program has cost taxpayers and farmers more money, than if they would have left the butter/powder purchase prices alone. Mr. Gutknecht, as a senior member of the Budget Committee, I think you should be very upset at the poor fiscal decisions that are being made at USDA.

Second, the USDA has failed to make use of the Dairy Export Incentive Program. To date, despite low milk prices; despite other countries' free use of WTO-allowed export subsidies; despite a clear overseas demand for the U.S. butter; and despite growing inventories of Government-purchased butter; the Department has issued invitations for a mere 5,000 metric tons of this program, less than one-quarter of what is allocated. That is inexcusable.

Although I did hear that they did allocate 5,000 new metric tons yesterday, right before this hearing. I hope we can have hearings every week. As the Chart illustrates, we estimate that the 5,000 tons of butterfat awarded under the DEIP in March, increased wholesale butter prices by only 6 cents a pound. But to farmers, that translated into a revenue boost of $20 to $30 million because the all milk price rose about 18 cents a hundredweight.

Third, in its administration of the Milk Income Loss Contract Program, the Department disenfranchised a large swath of medium sized producers, in the way it implemented the program. Chart No. 4 illustrates how this middle group of producers was disadvantaged by the lower overall payment rate that either small or large farmers, who received much higher payment rates.

Fourth, the USDA responded last year to the drought affecting much of the country, in providing compensation to affected livestock producers. That is all well and good. However, the drought disproportionately affected regions with especially large farmers, who were often disqualified from assistance by the Department's decision to limit eligibility on farm size, and those hit hardest by the drought.

The Farm Service Agency did administer a Drought Assistance Program last year that was effective. This year however, the Department chose to bypass experienced FSA staff and allow the target States, who do not have experience in such programs to write their own rules. Only after a united outcry by manufacturers of whey products, did the Department tighten the provisions.

Fifth, the 2002 farm bill also included a provision that requires dairy exporters to sell their products in the U.S. as well as producers who pay their fare share to promote dairy consumption.

But the USDA has failed to implement the promotion assessment, even though by my calendar, the farm bill passed 53 weeks ago today. And we understand that, that is in violation of the law, and it is also clear that the U.S. Trade Representative's office is also part of holding this up. I urge this committee to work with USTR, and USDA and other administration officials to see that the intent of what this Congress passed is not thwarted.

Finally, let me speak to the one legislative measure that is a top priority for NMPF. We overlooked MPC's in our last trade negotiations, but our trading partners did not. They recognized the potential and they protected their markets; but we left a loophole through which 804 million pounds of nonfat milk equivalent, of casein and MPC came last year. This compares to 556 million pounds in 1993, as chart No. 5 illustrates. Together, the economic impact of these dairy imported proteins has had an enormous impact on dairy farm revenue. We estimate $3.5 billion since 1993.

In conclusion, I hope that your oversight of this Department, can effect some changes in the current administration of USDA's programs. Dairy farmers today are desperate. They need a friend in USDA; instead, they are losing faith in an agency that has an economic tin ear. My last chart, shows that the all milk price beginning 2001, when the current USDA team came into office. We have noted the two tilt adjustments. While I appreciate the time you have given me to speak on behalf of the dairy producer community, I think this chart speaks for itself.

Thank you.

[The prepared statement of Jerry Kozak appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Well Mr. Kozak, we asked you not to sugarcoat it and you have not. Thank you very much.

Mrs. Tipton.

STATEMENT OF CONSTANCE E. TIPTON, EXECUTIVE VICE PRESIDENT, INTERNATIONAL DAIRY FOODS ASSOCIATION, WASHINGTON, DC

Ms. TIPTON. Thank you, Mr. Chairman and members of the subcommittee. I certainly appreciate the opportunity to appear today on behalf of milk, ice cream and cheese processors, manufacturers, and distributors across our Nation.

We certainly recognize the problems of low farm milk prices and the threat that these pose to many dairy producers. But because of this we think it is really important to focus on the dairy policies and programs, and what some of the fundamental problems are that exist as a result of those programs. And we believe it is especially important to look, not only at supply and demand, and to Government for solutions; but also, not only supply and price and Government for solutions, but also to demand and to markets.

I think it is really stunning that is becoming apparent and widely accepted across the entire industry that the basic programs that are intended to provide orderly marketing, and to provide a safety net for our dairy producers are not working. And I would like to highlight just a few points.

First, on Federal Milk Marketing Orders, these are not working as originally intended. And today, are at the root of many of the industry's problems. They have created regional differences, that are detrimental to producers, where fluid milk is lower than the national average, and I know you know that well, Mr. Chairman, that is the case in your district.

They lock milk into class uses. This classified pricing structure often keeps milk going into class uses, regardless or demand would otherwise drive it. We think that deprives producers of the best prices they might otherwise get. And the Dairy Price Support Program has made these regional distortions worse. When nonfat dry milk prices were kept high, along with high market butterfat prices, that drove the base prices for Federal order pricing much higher than otherwise would have been. And if we are going to continue a Price Support Program, that purchases products in surplus of the market, then we have that managed to keep the product prices in alignment with the markets.

The product prices in the Dairy Price Support Program had not been adjusted in a decade. And at the same time, market demand shifted greatly. The use of butterfat was much in demand through increased cheese consumption, at the same time nonfat dry milk demand had declined. And that is what really started our major buildup of nonfat dry milk.

We, unlike Mr. Kozak's group, applaud the Department of Agriculture for making long needed adjustments in that program to bring it into better alignment with the markets. The purchases of nonfat dry milk have also encouraged continued production of a

product, that is not in market demand in lieu of other milk protein ingredients, for which demand has been growing.

It is essential to realize that these very complex programs are interrelated, and sometimes counterproductive. For instance, the Dairy Price Support Program assures a market for nonfat dry milk. At the same time, the Federal Order Program ensures that the manufacturing costs are covered for that product. As a result, there is only incentive to keep producing this product, even though demand has decreased.

The answer is to revamp the underlying programs, not start another new subsidy program. A critical component for healthy dairy industry is product demand, selling our products to consumers. Cheese has been the leader for over the past 20 years, with consumption growing today, to over 30 pounds on a per capita basis. Milk is doing its part to try and compete in an increasingly crowded market, and teams have been identified as the sort of battleground in the beverage market.

Milk producers and processors on the one hand, are trying to keep that market. Other beverage manufacturers who are often much better funded, and don't have to deal with these regulatory systems, are trying to steal them away.

Today as you mentioned, we brought some of the newer, single serve milk products in for the committee to sample and to see. Many of these are targeted at this teen market, and you can see, there are a wide variety of flavors and packaging that will appeal to kids and teens.

But the point I want you to clearly understand is that the price regulations we are talking about here today are a burden and an impediment to milk's ability to compete as effectively with other beverages as they might. None of milk's competitors have similar price regulations on their ingredients.

One other issue I'd like to touch on is risk management. If you look at milk prices over the last 15 years, you can see the dramatic increase in price volatility. As a result, there is a need to provide basic market tools that allow milk buyers and sellers to manage these price swings. And a simple tool that is used by most other commodities, is forward contracting, which permits buyers and sellers to smooth out those seasonal price swings.

We believe that the Pilot Program now in place, giving milk buyers and sellers the ability to have voluntary contracts, should be turned into permanent authority for all milk buyers and sellers.

And in conclusion, we believe that there should be one's national safety net for dairy, that is fair across regions, and has the least market distorting effect, while providing critical assistance to producers when it is needed. We recommend that the Federal Order Classified Pricing System be revised to allow market demand to play a greater role in moving milk to its highest value use. And above all, we recommend rejecting short sighted programs, such as regional dairy compacts, that will only exacerbate regional distortions in an industry that has increasingly national markets. We must have policies that don't lose sight of demand, by only focusing on price and production. And we must have policies that allow us to grow markets, both domestically and internationally.

We are certainly committed to working with you, Mr. Chairman, towards a policy environment that allows our industry to prosper at all levels. Thank you.

[The prepared statement of Ms. Tipton appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mrs. Tipton, and thank you, Mr. Kozak. Let me go first of all, to talk about National Milk's program, because we have had some discussion here at the committee today already, about the Cooperatives Working Together Program. And I am wondering, Mr. Kozak, can you tell us a little more about the program? And then I think one of the questions we are concerned about is, how do you deal with the free riders, the folks who don't really participate, and can you tell us what level of support you have already and when you expect to roll it out? And then finally, if it is not too much to ask, just for the benefit of the rest of the committee members and others who may be paying attention to this hearing. Talk a little bit about the 18 cent per hundredweight assessment, and the response you have had to that.

Mr. KOZAK. Well thank you, Mr. Chairman. I'll give you a thumbnail sketch about the hundredweight program. I would be happy to do that. One of the things that I must indicate that we are in the process of finalizing the details. We are going through an extensive legal analysis and review to structure the program, in a way that minimizes any potential problems down the road. So I will be reticent on certain—answering certain questions.

But overall, the Hundredweight Program is a multi-faceted or multi-dimensional program. It contains three basic elements, under a self-help concept. It doesn't require any Government intervention, and nor, do we want any. It is a——

Mr. GUTKNECHT. And Mr. Kozak, on that point, can you share with the subcommittee some of the things you told me earlier about why you don't want the Federal Government involved?

Mr. KOZAK. Well there are a couple of issues. For instance, as I mentioned, as a multi-dimensional program, we have an Export Assistance Program that we intend to manage through the Hundredweight Program. It is our contention after looking at WTO and other legality issues, that if this program is fully funded and operated only by dairy producers, we would minimize to the greatest extent any challenges down the road in terms of WTO obligations. If the Government were involved, we would have some serious difficulties. So there is a specific area of which, by a self-help program, funded by producers, we intend to manage some export assistance levels.

Second, I am afraid that the term buyout has been used misappropriately. We are looking at a Herd Retirement Program, you will recall that in the Herd Retirement Program administered by the Government, I think there 1.6 million cows removed. We are talking about 125,000 cows, as part of a multi-dimensional program, so I don't consider it to be a major buyout.

And the third area, is to provide some incentives to producers who wish to reduce their production. And all three of these programs are designed to work in concert. I heard some of the responses from the first panel, and I would take exception to some of the answers, because although some of these programs are not

necessarily new in their concept. I think they are new in the concept, of working all combined in a program that will be administered by dairy producers. And so, at this stage, the National Milk membership has voted to endorse the program, the Board voted overwhelmingly, to ask the staff to put in place the structure, which we are doing now, to provide the proper legal structure as well.

They have targeted 80 percent participation in the program. And right now, I feel very confident that we will get that 80 percent participation, because within National Milk itself, we have 70 percent of the national supply. Sixty-nine percent of that has now voted on it, and we have pledges of participation from non-NMP of co-ops, as well as other producer groups, limiting it only to producer groups. And I feel very confident that by June 30, we will have signed up that 80 percent. Obviously the free rider situation, has always been one of the mitigating factors in any self-help program.

But, Mr. Chairman, as you spend a lot of time on a lot committees, not necessarily just related to dairy, we have free riders in our society, in many of our programs. Our plea to our producers is if we are going to worry about the free riders, we are not going to put this program in effect. Our membership has stepped up to the plate, and I am really anxious to complete the participation level. And I think it will be a step in the right direction. And I hope that answers most of your questions about it.

Mr. GUTKNECHT. We look forward to hearing more from you about this, because I used to work for the former captain of the Green Bay Packers, so we heard a lot from Vince Lombardi, or Lombardisms. And he said there are three kinds of people in this world: There are people who make it happen, there are people who watch it happen, and then there are people who ask what happened. And we are really very interested in seeing you guys make it happen.

Mr. Dooley.

Mr. DOOLEY. Thank you. Mr. Kozak, if I understand you correctly, you are highly critical of the administration, because they did adjust the butter/powder price tilt, in at least two separate occasions here. What would be the, if they had not adjusted those, what would be your expectation, what would have happened in terms of Government purchases?

Mr. KOZAK. Well I think in terms of Government purchases, our information shows, that we would probably be selling about what we are selling now, because if you look at the numbers for instance, from December 2, which is right after the tilt, you would see that we were selling 21 million pounds of powder during that period. After the tilt, for a few weeks from December 9 to the 27, it did drop down. However, if you look at the rest of the numbers, including now May to May 9, we sold 23 million pounds of powder. So we don't think that we would have been selling a far more powder than we would have, and the disturbing issue here is that although the Department saved $36 million in reduced powder purchases, because of the two tilts, they spent $10 million for additional butter, and $82 million more in terms of additional milk payments.

So part of our concern, Mr. Dooley, is the rationale. Because if we were to run our businesses the way that was run, we would be net $56 million in the whole. So we are struggling to understand the Department's mentality. In one case they want to save money in purchases here, but at the same time now, they are spending more money here, and the amount of powder is still the same.

Mr. DOOLEY. Just intuitively though, when you have the Government that is making massive purchases of powder to where we have 1.3 billion in storage now, and that we are in fact, seeing that sending a false signal to marketplaces, to some extent is that by doing that adjustment, it would seem to just make sense that we would be sending a more appropriate signal to the producers.

I guess you talked a little bit about on the MILC Program, about disenfranchising a group of producers on the transition. And I think there might be some merit in your comments in terms of that transition. But when you talk about disenfranchising a group of producers, I think your National Milk Producers Federation supported the MILC Program or policy. It is disenfranchising, the vast majority of producers in my district. Because if you do the analysis, in terms of what is the net impact of a 1,000 cow dairy in my district, is that this program is actually costing them money, if you accept Dr. Cropp's figures that this is resulting in a 25 cent a hundredweight reduction. And if I do the figures as information that is provided at $1.45 in terms of the payment that is going out, on a dairy in my district of 1,000 cows, with a 21,000 pound a year production, it is costing them over $17,000 a year. And if we go to a 2,000 cow dairy herd in my district, where there is a whole lot of them, is it is costing them $70,000 a year. How are you representing the interest of the most productive dairy sector in the country, in the production side? And we are going to have Chuck Ahlem who is going to speak here afterwards, who is one of those guys. When you are advocating a policy that is resulting in my producers losing over $70,000 a year.

Mr. KOZAK. Well first of all, let me remind you that when National Milk testified both before the House Agriculture Committee and on the Senate Agriculture Committee, we did not offer the Milk Payment Program as one of our policies. In fact, we had advocated a class III Enforced Supplemental Program, which we think would have been far greater impact on helping the producers in your area, and some of the other areas. Unfortunately, the Congress both in this House and in the Senate didn't accept our class III Enforced Supplemental Program. Instead, there were bills introduced in the Congress, as you fully are aware, that were in relation to trying to deal with the loss of the Northeast Dairy compact. The first set of bills National Milk was against, because that was even a more terrible program. That would have disenfranchised 33 States versus 12 States. And we came out in full support against that program at National Milk. Whether we were in favor of the program or not, I contend that we would have been given the Milk Payment Program.

Connie can also respond to it, because I don't think that I did effete in any statements were against the Milk Payment Program as well. And so it isn't just the industry that we represent.

Mr. DOOLEY. Are you an advocate then for making major modifications in this program?

Mr. KOZAK. Yes.

Mr. DOOLEY. And what would those be?

Mr. KOZAK. I think that we, first of all, we testified on that Milk Payment Program, and we said that there should be no caps on that program, that all producers should be treated equally. Obviously, that is one issue that we still maintain if we are going to have that kind of program.

Mr. DOOLEY. Excuse me just a second. If you are advocating for no caps on the program, then Dr. Cropp's analysis, where with this limited approach would have a 25 cent a hundredweight drop in prices, is that we would see a continuing escalation in terms of the cost to taxpayers, and even a far greater price on the drop on the market price if you didn't have a cap on it. I mean his analysis that FAPRI has done on this, has indicated that if you didn't have a cap on the program, you would have a dramatic reduction in milk prices from the marketplace.

Mr. KOZAK. Well now we are mixing apples and oranges in a sense, because I don't think we are in agreement with Dr. Cropp's assessment. We did look at the FAPRI analysis, certainly Dr. Cattelliani just got it so I don't think we are in a position to give you a specific verbal answer today. We would be happy to supply a more detailed response.

But when you asked about modifications, one of the modifications is still that we should be treating producers, whether regardless of the size of the farm, equally and equitably. That is the beauty of the program that we are putting together under the Hundredweight Program. If you were to take away the Milk Payment Program, which is not what I am advocating. But if you were to take it away, you would see that the returns under the Hundredweight Program a producer funded program treats all producers equally. That is one of the modifications that I do think I agree with you, has to be done. There has to be some modification to the program, so that we don't disenfranchise producers, and we don't pit small versus large.

Mr. GUTKNECHT. The gentleman's time has expired, and I really appreciate that last comment because that is one of the problems we have had. The gentleman from Michigan, Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman. Would you in terms of the herd buyout, would you have some kind of balance, so that the herd buyout would be somehow distributed across the country? How would you do that or would you just do it by economics, where can you get the biggest milk production?

Mr. KOZAK. Again I would say that I would ask us to use the Herd Retirement Program, because buyout I think causes some apoplectic response from our colleagues in the Cattlemen's Association. One of the things that we are attempting to do, is to put together a program that is sensitive to the needs, not only of our producers, but other agricultural commodities such as in the beef area. We are planning to do it in a way that will be done over a 4 month period of time. As I mentioned, it limits the amount of cows that we are talking about. We have put in place some regional——

Mr. SMITH. I was just wondering about geographical reduction in the West, or the East, or the North or the South?

Mr. KOZAK. OK. We put in place regional safeguards, one of the beauties of designing a program ourselves, is that we can take into account those issues that our membership is concerned about. We put in five—we have set it up in five regions, and we have made sure that no region disproportionately loses a major part of their milk supply; because there are regions who are still in milk deficit areas. So our regional safeguards ensure that no one region, will have either a reduction in milk, either through the Milk Reduction Program, or in the Herd Retirement Program, that will cause a marketplace disruption. So we have planned for that in the program.

Mr. SMITH. It is interesting, some of the similarities over the old NFO Program. So NFO was trying to get a greater signup or dumping milk and reducing some dumping milk, and actually having a called core cow sale to remove some of those call cows into the beef industry. I don't even know if they, I mean I guess they have given up that program, right?

Mr. KOZAK. I think they still have a purchase program for call cows, but I am happy to report that NFO was one of those organizations whose Board voted to fully support and participate in the Hundredweight Program.

Congressman, one of the things I think that is critical for you to understand is that we are, all we are attempting to do is to balance a supply at this point with demand. And as we proceed on that particular fashion, I think it is also important to note, Mr. Collins' comments. We intend to have this as a long-term program. And so, we expect that for the long-term, we will put in place some other modified programs that will help us do that.

Mr. SMITH. Well I am a co-sponsor of Mr. Obey's bill on limiting imports of protein solids, and because I just couldn't think of any other way that we are going to accommodate it. But I want to ask you a question, Ms. Tipton, because it has always been sort of my presumption, when I was very young, we started the marketing orders, because what we found out was that the buyers of milk, would sign a contract with the farmer, for whatever, $5 a hundred. And if more milk started coming in than they wanted, they said well we can't afford to pay you $5 a hundred anymore, because we are getting too much milk. The farmer says but I got a contract, and the processor says well tough luck, sue us. Either go along with $4.80, or we are not going to pick up your milk tomorrow. So I see, I still see the potential of a little conflict of the processors and the retailers, trying to buy dairy products at the lowest possible price, and sell them at the highest possible price, as long as the lowest possible price still accommodates their need of supply.

Ms. TIPTON. Congressman Smith, you started out by mentioning the Federal Order System and that was put in place back in the Depression. I don't think you were born yet.

Mr. SMITH. Oh yes, I was. You tried to help.

Ms. TIPTON. But it was put in place for orderly marketing, I would submit that the conditions at that time however, were dramatically different and at that time as you rightfully note, the producers were a lot on their own.

Mr. SMITH. 1932 I thought, so I was very young at 1932.

Ms. TIPTON. But producers were very much sort of free agents at that time, and there weren't as many cooperatives, and the producers did not have the advantage of the members of Mr. Kozak's group, to bargain on their behalf as their own groups. Today that is quite different. Most producers are members of the co-ops, that Mr. Kozak represents. And they have quite a bit of bargaining power. I think there was a statement earlier, that the top three co-ops represent over 40 percent of the milk supply in the United States. In fact, one of those co-ops represents 25 percent. So today, is a very different dynamic, I would submit that the farmers do have considerable bargaining power through their co-ops. Milk processors on the other hand, I don't represent retailers, so I won't speak to what their position is in the market, but there obviously has been a lot of consolidation throughout the industry, at all of those levels. The retail level, the processing level, the farm level. And this is to create efficiencies, this is to do a better job of marketing our products at all of those levels. And I think we are seeing that. I think everybody is concerned about doing the best job of marketing the products, and in the end, selling the best we can.

Mr. GUTKNECHT. The gentleman's time has expired. The gentleman from California, Mr. Cardoza.

Mr. CARDOZA. Thank you, Mr. Chairman. I have two quick questions, Mr. Kozak. Sir, what do you believe will happen when FDA approves milk protein concentrate for block cheese? Currently it is my understanding that the approval has moved from the B list, to the A list on their priority. And couldn't this possibly devastate the domestic cheese production, if something is not done to limit either MPC imports, or increase in domestic production?

Mr. KOZAK. Well one of the, I think one of the issues that is often overlooked Congressman, is that we are producing milk protein concentrate in this country.

I have heard a number of statements today, that sort of indicates that we are not. We have a fairly active and aggressive farm level program in many farms, to produce liquid concentrated ultra-filtered milk protein concentrate. And as Connie would probably tell you, I was partly responsible for helping to move that along when I represented the processing sector. So we are in full agreement, that using liquid ultra-filtered milk protein concentrate in cheese products, under the petition that was filed by the American Dairy Products Institute, we find would be acceptable.

Where we have a great deal of concern, obviously is the use of milk protein concentrates in dry form, for a number of reasons. So we are concerned how the Department will publish the regulations. Having worked at FDA a part of my career, I would caution you, that when something moves from the B list to the A list, that doesn't necessarily mean the A list moves at anything other than turtle speed at times. So we are somewhat waiting to see what they are doing in that respect.

Mr. CARDOZA. Do you support Mr. Obey's bill on milk protein concentrate, limitation of imports?

Mr. KOZAK. Oh absolutely, we are in full agreement with both the Congressman Obey's bill and Congressman Sherwood's bill both the cosponsors, and also in the Senate side. I think as to date, we

have 122 sponsors for that bill in the House, and 25 sponsors on the Senate side. I think that obviously, that Congress is interested in that, in passing that legislation.

Mr. CARDOZA. Do you share Ms. Tipton's request for expansion of forward contracting?

Mr. KOZAK. No, and one of the things that we are disappointed about is the lack of review of this pilot program. We did our review from the USDA, and here is a couple of issues that we are concerned about. When you look at the simple average, that was contracted for milk, it was $14.02 per hundredweight. The same milk would have been paid $14.51, without contracting. Calculating the data, we showed an average weighted loss over that study period, was $1.23. So we have serious concerns as to whether or not this program benefited producers.

But here is the more serious issue, that we are concerned about, and that is this. USDA in their own reports said, that 7 percent of the contracting producers, felt obliged to sign a forward contract, or lose their outlet for milk. I think that is a serious issue, that requires this committee to take a much more full extensive review. Because if producers feel coerced to sign a contract, or list they would lose their ability to outlet milk, I think that will be the death of forward contracting, and I think it needs much more further review.

Mr. CARDOZA. Thank you.

Mr. GUTKNECHT. The gentleman from California, Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. Ms. Tipton, you have expressed your frustration with the Federal Milk Marketing System and the orders, and I think that all of us share that frustration; because it is very difficult at times to make changes to the system. And as the last farm bill was quite contentious, where now we have a program that is supporting smaller dairy farms, which Mr. Dooley has quite appropriately pointed out; and thus, costing our farmers in California money.

I am a little though confused as to why, your groups oppose the system, when you are now buying milk at 25 year lows, and then in the grocery store, I would have to say that we are at all time highs. And I just wonder how the relationship works there between the dairy farmer, your processors, and then the retailers?

Ms. TIPTON. I would be happy to answer that. Certainly our members are benefited by low milk prices in the short-term, Mr. Nunes. But they recognize that the long-term interest is to have a very adequate and reliable milk supply, and you can only have that, if you have a system that helps dairy producers stay in business and be efficient and make a decent living. So we want programs that work. If we are going to have Federal Programs and regulations, then they need to work, and they need to work for the farm sector, and they need to work for producers of products, so that we can build demand for those products. What we have now, I think you have heard both Mr. Kozak, and me agree, that what we have now is not working. We however, would not propose to put more programs in place, we would like to fix these underlying programs. We think there are things that can be done to move in the right direction, so that we let markets adjust.

Now with respect to the retailers, as I mentioned a minute ago, we do not represent retailers. But there has been a dramatic change, in the market with respect to the retail food industry, and with respect to virtually every other industry in the United States. There are fewer retailers, and they are larger. They have different strategies, many of them are publicly owned. I could not tell you what their strategies are, but I do know, that there are a lot of variety of outlets that consumers have the opportunity to go to. They can go to a Cosco, if they want a low priced product, or they can go somewhere nearer to their house, that may have a higher price, but it is more convenient. So product choices, are something that are positive for consumers. I don't want to defend anybody's particular retail prices, because we don't have anything to do with that. But I would just say, that the dynamics of the marketplace are important, and it is important that they can work, and it is important that we do not have programs that stand in the way of that.

Mr. NUNES. Right, I mean I understand what you are saying, but as you know, milk is relatively an elastic product. What changes, would you want to make to the Federal order, or the Federal orders?

Ms. TIPTON. Well for one thing, we think that the multiple classes that are in the Federal Order System. There are four classes of milk. We think that this is locking milk into those class uses. Each of those classes is set with a manufacturing allowance for production of whatever that product is. As you know, there are higher differentials, for class I, for milk going into class I products. The whole system is so structured now, and so detailed, that you have got most of the milk, except for California's milk, moving through these classes, and getting locked into those classes. It no longer has the ability to be bid up to its higher value use, because you have got these manufacturing allowances built in. It is a very complex system, but it is not working to let milk move to where it would be for its highest value use. That I think, is leaving money on the table for producers. And it is also distorting markets. You have got a lot of regional distortions. The chairman's district happens to be in an area where the class I utilization is relatively low, it is about 20 percent. That means that they are getting fewer dollars for their farmers, because of the structure of this system. This system is very discriminatory, and I think it needs to be looked at and the class prices are really the root of that.

Mr. NUNES. I am glad to see that you want dairy farmers to get more money.

Ms. TIPTON. I think the market could return a lot better price to dairy farmers, than what we are getting out of these programs today.

Mr. NUNES. Mr. Kozak, could you comment?

Mr. KOZAK. Yes, I think I would like to comment on that. First of all, let me be clear. My testimony today did not advocate any new programs. So when it said we need more programs that, we did not advocate new programs. What we are saying is the programs are not being administered properly. And if they were administered properly we wouldn't have the kind of prices that we have now.

Second, we have done some analysis of whether or not we should eliminate classified pricing. And our analysis is pretty clear. And we would be happy to give you in written form further details.

But if we were to eliminate the present classified system, producers stand to lose more money. And that is one of the reasons why we don't share that view. I do think that we are in agreement in one case, and that is about the retail level. If you look at the farmers share of the retail price of dairy products, it is now 28 percent. Which means that somebody else is getting a great deal more money in the chain. And as Connie mentions, they don't represent retailers. We don't represent retailers, but one of the reasons why you have seen consolidation for instance, in the cooperative area, is that we can become larger, so that we have a greater say as we negotiate our contracts. It is not working very well, because the farm to retail spread is continuing to grow, and I think that is another area, that this committee needs to have review and analysis on. I would encourage you to see what is happening there, and why farmers are only getting 28 percent.

Mr. NUNES. Thank you. Thank you, Mr. Chairman.

Mr. GUTKNECHT. The gentleman's time has expired. Governor Janklow do you have questions?

Mr. JANKLOW. Very briefly.

Mr. GUTKNECHT. And Mr. King, do you have questions? All right, then here is what I am going to say we should do. We will take 5 minutes of questions here, and then we will dismiss this panel. We have got a series of three votes, we will have to recess for a half an hour. But we will let Governor Janklow go ahead, and then we will dismiss the panel. Thank you.

Mr. JANKLOW. I will be extremely brief. Is there anything with respect to the current operation of the dairy programs, you two agree on?

Ms. TIPTON. They don't work right.

Mr. JANKLOW. Well is there anything that you two agree?

Mr. KOZAK. They are not administered properly. That may be as close as you come.

Mr. JANKLOW. So you don't even agree on that. Let me ask you if I can, Ms. Tipton. Is there any program that you folks would support, your group supports, other than the market system?

Ms. TIPTON. Sure, we and we are not advocating getting rid of the Federal Order Program either. We would like to see the classified pricing system looked at, and perhaps collapse a kind of a safety net we have. We have talked about we have both the Dairy Price Support Program, and this Milk Income Loss Contract right now. And that doesn't seem to be working very well, we seem to be sort of counterproductive here and not letting the market signals get to the producers. So I think we need to revisit what is the safety net, and we need to have a safety net that works across all regions of the country. Yes, we can be supportive of those kinds of things, but we want to let the markets have the say in what is happening with milk prices.

Mr. JANKLOW. Mr. Kozak, in Mr. Collins' testimony, unfortunately, he testified before you did. His written testimony has that it that USDA has taken action involving the imports of American cheese. Do you agree with what they have done, and just say they

have not gone far enough? I am going to run you through all five of these real fast.

Mr. KOZAK. OK. Well the first thing is, it took them 3 months to respond to our request from National Milk to do the safeguards on cheese. And when they did it, they did it at the same time they did the safeguards, they put a new tilt in which wiped out any benefit, that we would have seen from that program.

Mr. JANKLOW. The use of nonfat dry milk for humanitarian foreign assistance. Do you agree with what they have done there?

Mr. KOZAK. I agree completely with you, I think that we need to be much more aggressive in how we administer our donation programs.

Mr. JANKLOW. The Dairy Export Incentive Program, do you agree with what they have done there?

Mr. KOZAK. Absolutely not, they need to make those allocations available to the industry all at one time. Allow the commercial marketplace to administer DEIP, which was the way it was operating and not do it in trounces, and certainly not hold back on the butterfat DEIP any longer.

Mr. JANKLOW. The Livestock Compensation Program?

Mr. KOZAK. Do it in a way that it impacts the producers who need it the most.

Mr. JANKLOW. And the MILC Program, you have already testified on the MILC Program. With respect to the Milk Price Support Program?

Mr. KOZAK. Well I think it is clear, we have submitted the information. The only way the Price Support Program works is when manufacturers can clear the market in selling their product to the Government. Our survey shows that the cost of selling to the Government are far higher, than what the Government is willing to pay, and that is making the Price Support Program ineffective.

Mr. JANKLOW. Mrs. Tipton, you saw the charts I assume, that Mr. Kozak put up during his testimony?

Ms. TIPTON. I glanced at them, yes. I didn't have time to study them.

Mr. JANKLOW. Could I ask you if you would please, on behalf of the organization, look at those charts and submit in writing to the committee, what it is that you think has caused each of those fluctuations in changes in the charts?

Ms. TIPTON. Absolutely, I would be happy to do that.

Mr. JANKLOW. I have no further questions, Mr. Chairman. Thanks for your indulgence.

Mr. GUTKNECHT. The gentleman yields back his time. And I am going to excuse this panel. But I would advise members of the subcommittee, that we do have some producers coming in, people who actually meet these cows everyday. And they are going to be testifying when we come back. I am going to recess the committee until approximately 1:20, when we hope to come back, and we will actually hear from some real people, who actually milk real cows.

Mr. JANKLOW. Mr. Chairman, I can only not come, because I have to speak on the floor on Healthy Forests Initiative, otherwise I would be here.

Mr. GUTKNECHT. The subcommittee stands to recess.

[Recess.]

Mr. GUTKNECHT. I call the subcommittee back to order. We have on the floor right now, we are debating the Healthy Forests Initiative which is a bill that we are in part responsible for not only on this subcommittee but on the full committee, and so a number of the committee members are down there participating in the debate on the Health Forest Initiative.

But we are pleased to have a distinguished panel of real dairy producers representing different regions, herd sizes and perspectives from all around the country.

First of all, Mr. Bill Rowekamp from Lewiston, MN. Mr. Charles Ahlem, am I saying that right, from Turlock, CA. Mr. Brian Boehning, from Earth, TX. Mr. Sidney Grove, from Ridgewater, VA. And finally, Mr. Gordon Hoover, from Gap, PA.

We are so happy to have you here today. We apologize that this subcommittee hearing has gone on a little longer than we had originally anticipated, and Members have an awful lot of other things going on. But we are so happy to hear from you, and we will start with Mr. Rowekamp. Welcome to the subcommittee.

STATEMENT OF BILL ROWEKAMP, DAIRY PRODUCER, LEWISTON, MN

Mr. ROWEKAMP. Thank you, Chairman Gutknecht. I want to thank Chairman Gutknecht and other members of this subcommittee for asking me to testify and my review of the current state of the dairy industry. It is a privilege to testify before a subcommittee, led by my representative, Chairman Gutknecht. His hometown of Rochester, MN, is located near my family dairy.

For more than 80 years, members of the Rowekamp family have lived and milked cows in southeast Minnesota. I began helping my father Everett Rowekamp milk 28 cows in the late 1950's. When dad retired in the 1980's, we were milking 100 cows. Today, my family is milking 235 cows, with plans to build a new 2,500 cow dairy in the near future.

It is ironic that I am planning an expansion while milk prices are at a 25 year low, but I am bullish. I am bullish, however, on an industry that has long been my family's livelihood and a Midwest stronghold.

The Midwest dairy industry has been struggling to maintain producers and infrastructure. I know firsthand, the State is working to reinvent its industry. About 73 percent of the Minnesota dairy farmers recently surveyed by the Minnesota Department of Agriculture, plan to maintain or increase herd size in the coming 5 years. This is good news after years of falling cow numbers and stagnating production levels.

This industry could turn around with the help from agricultural leaders such each of you. When taking steps to improve the dairy industry, I ask you to focus on the existing dairy price support system and the need to close milk protein and trade loopholes.

Allow me to first examine the Dairy Farm Income Support Program, included in the 2002 farm bill. Quite frankly, the dairy price support system is not working. The farm bill calls for USDA to maintain a safety net of $9.90 per hundredweight. This has not happened. Class III prices have fallen below that level for 8 of the last 10 months.

To maintain the price system, dairy manufacturers sell surplus dairy products to the Commodity Credit Corporation, at prices determined by the USDA. These prices should reflect the support price called for in the farm bill.

That system, however, has not been effective. For several weeks, commercial markets remained 5 cents per pound under CCC prices, indicating that USDA calculated prices are too low.

Too make the farm bill effective, I recommend 2 improvements. The first is asking the USDA to increase its purchase price of cheese, butter, nonfat dry milk to reflect the additional costs manufacturers will face when selling products to the CCC.

The second improvement would be for the CCC to become an active trader on the Chicago Mercantile Exchange. The CCC could purchase products on the CME whenever prices dip below the established CCC purchase prices. USDA could actively ensure the price levels called for in the farm bill.

In addition to support prices, the farm bill provides an additional safety net through the MILC payment. Without MILC payments, the rate of dairy farmer loss would be much higher. Though my farm production has surpassed the annual MILC payment limit, I appreciate the positive effects it has had on my fellow producers, our communities and the dairy infrastructure.

If USDA improves the price supports I have outlined, Minnesota dairy producers could be less dependent on MILC payments. Proper administration of the support program, however, would lower the MILC payment and generate more money from the market. This is a win-win situation for dairy producers and taxpayers.

Let me also draw your attention to another win-win for dairy producers and their communities. In addition to milk, dairy farms could be generating electricity with anaerobic digesters that produce methane. This renewable fuel source powers generators. The energy bill should contain tax credits to encourage the production of this alternative energy source.

Also, on the State and local level, talking about Minnesota now. The State and local policies and politics, have played a major role in the lack of reinvestment in the existing facilities and the building of new ones. In Minnesota and the upper Midwest have overhauled their rules regulating feed lots and now has some of the strongest, most complete and environmentally sound rules in the Nation.

These rules are not the problem. The problem begins with how the rules are interpreted by pollution control officials. Also, a bigger problem is local citizens oppositions spurred on by lies, fear tactics and intimidation of local producers and officials in using the threats of lawsuits, by so-called environmental groups. There are good environmental groups that want to work with farmers, but also, there are other groups that are no more than social change and social justice activists, that are a danger to agriculture.

We need laws protecting us and our rights to use our land, while protecting the land and the environment for the next generation. This might be more of a State issue, but I think leadership from the Federal Government would send a strong signal to the States that farmers have rights, and they need to be protected.

Finally, I want to talk about the problem of imported dairy proteins, such as milk protein concentrate and casein.

Clearly, imports of milk protein concentrates are not the sole cause for low dairy prices. They do, however, displace domestically produced nonfat dry milk that is purchased by the USDA under the Dairy Price Support Program. This purchase then leads to a build-up of support of surplus dairy proteins.

When reviewing the 300 percent surge in dairy protein imports since the mid 1990's, it is clear to see how the import loophole had affected dairy producers in the past. But in many ways, the dairy protein tariff legislation is about the future.

The MPC bill does not seek to stop all MPC imports. Rather, it brings consistency to the dairy tariff schedule, so loopholes don't allow import surges that prevent our domestic dairy industry from recovering.

If milk markets recover, the U.S. dairy industry will grown even more vulnerable to MPC imports. Some U.S. manufacturers want to purchase cheap MPC's from other world markets, before supporting their own domestic industry.

Chairman Gutknecht, effectively administrating existing dairy price support systems, maintaining the MILC payments, and imposing tariff-rate quotas on imported dairy proteins, would move this industry forward. It would help the Rowekamp family farm continue to be a Southeast Minnesota dairy producer. Thank you.

[The prepared statement of Mr. Rowekamp appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Rowekamp. Mr. Ahlem.

STATEMENT OF CHARLES AHLEM, DAIRY PRODUCER, TURLOCK, CA

Mr. AHLEM. Mr. Chairman and members of the committee, I thank you for the opportunity to speak before you today. My name is Chuck Ahlem, I am a dairy operator and part owner of Hilmar Cheese Company, in Hilmar, California.

I would also like to let you know, that our family just celebrated 100 years in this country, being that our grandparents migrated from Sweden during the famine. At that time they didn't have the Government to put the wheels on the wagon to get them here. They made it here in one way or the other.

As you know milk production continues to move West. In the last decade, we have seen California grow over 58 percent, Idaho 160 percent, New Mexico 191 percent, and Arizona 92 percent. Traditional States have remained flat or tended to decrease in supply. Basically because the capacity and efficiencies of some of the cheaper land, and the opportunities in California, the weather and environmental situations have limited them to a more efficient way of producing milk.

And that part of those processing facilities tend to follow the raw milk supply, it is easier to ship finished product, than it is raw product. Farm growth size there has been dialog that all of the dairies are going to be 10,000 cow dairies and very few of them. I think the reality is, there is going to be some larger dairies, but the medium size dairies are going to continue to flourish for a number of years. They will provide the kind of market and provide the

efficiencies that are needed. 1,000 cow herds to 3,000 will probably be a norm amongst a lot of them, because of some of the bioterrorism issues of animal health issues, and putting all your eggs in one basket, and I don't think the Government would be willing to pay for those animals if you have an outbreak of some sort.

I really believe that the Government should not interfere in the marketplace. I think an example is that our MILC program which really stimulates over production, it sends the wrong signals, depresses the milk prices, and to our Californians it created a net loss according to the FAPRI studies.

I have seen very successful examples of the Federal and State Government and the producers working together to solve some of our problems. Focusing on long-term viability, I think the voluntary self-help programs are a very positive way to go, not over the Government mandated programs. One area, an example, the tax policy. I think the tax policy needs to provide the dairymen an opportunity to stay in or to get out. Often the tax structure creates a person, the only way they see of getting out of the business, is with feet first. The idea of selling and tax consequences, doesn't give them a lot of hope.

Federal Milk Marketing Order system. I am supportive of the order system, as long as it doesn't create an interference in the marketplace. The regulated price must be as low as possible to enable the marketplace to work and to send the appropriate signals. I feel the system does support a place to provide a true safety net, so if we have 1 or 2 bad years, the industry can actually, the individual farmer, efficient farmer can stay in business.

It is not for short-term fixes. So I think the Secretary must make timely adjustments in the butter-powder tilt, in order to develop more efficient methods on sales and transactions for cheese. The Government should not be the processor's regular customer. An example of some of the impacts of the burden of moving nonfat dry milk through the livestock industry has been a real depressor on the whey markets.

Current Government programs. While I support the Federal Milk Marketing Order and support price. But I think we have got some, as evidence to hear today, some very, very strong producer and co-op organizations and entities that show that they can work together and work on solving some of their own market problems. The Federal Milk Market Order Program came into being when the owner entities, or producers were very small and inefficient.

This is a new day, now we have multibillion dollar co-ops, large producer organizations that really have the size and scale to perform the kind of functions that the Federal Milk Marketing Order is performing today, in working with those market issues.

I do support the DEIP Program, but I feel that it should be a policy of developing markets, finding new markets out there, not a dump and run policy.

The State and local governments, I have seen them where they can work together through partnerships of our environmental, our Dairy Quality Assurance Programs.

In conclusion I would like to offer, rather than spend billions of dollars in the MILC programs and other Government programs, support us on the other side, the environmental structure, research

and development of new dairy products expansion and penetrations into new markets, and improved technology. We clearly need more investment in these areas, we do not need a mechanism that creates larger milk supplies, the products that may be made to go into Government warehouses.

There will never be enough money to satisfy every dairymen's need to stay in business. I think the tough reality is we need to be targeting those funds so they can best be used for long-term sustainability to the dairymen in this country.

Thank you very much.

[The prepared statement of Mr. Ahlem appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Ahlem. Mr. Boehning.

STATEMENT OF BRIAN BOEHNING, DAIRY PRODUCER, EARTH, TX

Mr. BOEHNING. Chairman Gutknecht and ranking member Dooley, my compliments to you for calling this hearing to examine the general state of the dairy industry.

My wife and I own and operate a family dairy farm in west Texas. I believe my opinions are generally reflective of the views of most dairy farmers in the southwestern United States.

Though it is not a good time to be a dairy farmer, I do not necessarily believe that the Government can or should be the salvation of dairy farmers. Sometimes the "help" is the problem. While the Government can play a critical role in the stabilization of milk prices and the dairy economy, that role should be limited. Now dairy producers are experiencing problems when Government does more than it should. I appeal to you to curtail the financial assistance you are providing the dairy industry through the MILC Program, because those payments are leading to depressed milk prices nationwide.

What dairy farmers like me need are markets, not Government markets for powder that consumers do not want, but for bottled milk, cheese, ice cream and the like. A growing domestic market has been developing for milk protein concentrates. These are showing up in nutrition bars, power drinks, and other products. It is apparent consumers want MPC. In response to that, DFA has built an MPC plant in Portales, New Mexico. Also in the Southwest, Select Milk Producers operates several wet MPC plants.

The MILC Program is a poorly designed and costly program put in place, to replace the Northeast Interstate Dairy Compact. In spite of warnings of some dairy farm representatives, that the MILC Program would greatly exceed cost estimates and depress milk prices on all producer milk, we were told that the program was a necessary evil to reach a final agreement on the farm bill.

The Northeast Dairy Compact was market-distorting, but the amount of milk covered was small enough not to have a big impact on the national market. However, due to the national nature of the MILC Program, the impacts have been greater and a segment of the dairy production sector has not received the market signal that lower milk prices have been sending since the end of 2001.

The MILC Program sends signals to overproduce, while the Dairy Price Support Program requires the Government to buy the

product of the overproduction. This situation will cause continued low dairy prices, even after the MILC Program is over. This will also cost the Government billions of dollars in years to come, because the MILC Program and the Dairy Price Support Program can not coexist.

The MILC Program is causing lower milk prices for all sizes of dairies, in all regions of the country. In the 15 month period beginning in January 2002 and ending in March 2003, class III prices averaged $10.24 per hundredweight. In the same time period, class III prices and MILC payments on 100 percent of a producer's production, totaled $11.63 per hundredweight. The 5 year average class III price is $12.15 per hundredweight. So even producers eligible for MILC payments on all of their production are receiving 52 cents a hundredweight, less than the 5 year average.

This program negatively affects the income of average producers, while devastating the income of producers with above average production. Because I feel like the cost of 25 cents per hundredweight is way too low, that we have been hearing today as far as the impact MILC has had on a dairy industry.

The target price selected for the program is really the root of its price-depressing effect. The $16.94 a hundredweight class I Boston price, which translates to a $13.69 a hundredweight class III price, is too high. From 1998 through the end of 2002, the Boston class I price was above the target price less than 28 percent of the time. This guarantees the program will be in effect more often than not. It is a price enhancer, and not a safety net. The price sends a signal to produce more milk, even during an overproduction situation, like the one we face today. The research that has been done by several respected dairy economists, shows MILC has and will continue to hold milk prices at historically low levels.

Another problem is the payment cap. Payments are only eligible on 2.4 million pounds of milk per year. The average dairy in the United States, produces 2.3 million pounds annually. Therefore, this program puts the entire burden of reduced prices causes by overproduction on the shoulders of producers with above-average production.

The dairy industry has had a support price for the last decade around $10 a hundredweight. And in the past, when class III prices were at or near support levels for 2 to 6 months, economics would cause producers to adjust their operations through feeding, culling, or even retiring altogether. Then supply would correct itself without the Government buying very much product. This trend caused dairies to get larger and more efficient. The MILC Program goes against this 20 year industry trend.

From the early 1980's to the early 1990's, the dairy support price level slowly dropped from $13.00 a hundredweight, to the current $9.90 a hundredweight. This decrease in support level was implemented slowly to give the industry time to adjust, unlike the MILC Program, which was sudden and unexpected.

When the 2002 farm bill was adopted, the Congressional Budget Office estimated the total program cost of MILC to be $1.3 billion for the 5-year life of the program.

As of April 1, USDA had already paid farmers $1.25 billion. The fiscal year 2003 spending is projected at $2.4 billion. In March, the

CBO upped its estimates for the total cost of the MILC Program, to over $4.2 billion, more than three times the price tag the committee agreed to last summer.

To put this in better perspective, from 1998 through the end of 2000, the average total dairy program cost to the Government has been less than $500 million per year. 2003 alone has projected to cost $2.9 billion. It is obvious this program is cost prohibitive to the Government. Thank you.

[The prepared statement of Mr. Boehning appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Boehning. Mr. Grove.

STATEMENT OF SIDNEY E. GROVE, DAIRY PRODUCER, RIDGEWATER, VA

Mr. GROVE. Mr. Chairman, thank you for the opportunity to speak. I must say, Mr. Chairman, I don't know if it was an omen or not. But last night as I was looking over my notes I reached for a pen, my elbow hit the remote control switch, suddenly C-Span appeared, and there you were saying so long to Larry Combest, so I spent some time with you on C-Span last night, and appreciated your remarks.

I am the owner-operator of a 100 cow family dairy farm in Virginia. I would make this statement that there is a world of hurt in the dairy industry. That statement was made at a meeting I attended in September 2002. Since that time, prices have continued to decline. The market for perishable products, whether it be fruits or vegetables or milk, overreacts, as you know, to demand and supply and balances.

I am concerned that a market that behaves in an erratic pattern, gives an opportunity to bottlers and retailers, and others for ever increasing margins while dairy farmers suffer. You heard this morning from testimony that our share of the food dollar, the consumer dollar is about 28 cents. The Nation's largest bottler of milk, has just reported quarterly earnings of $63 million. During the past 3 years, their stock has doubled, exactly doubled. It was one of the only stocks that I purchased in recent years, that made any money.

Some would ask what new dairy programs do we need? I would suggest as others have, that more focus and attentions to the programs we have, would be in order rather than creating new programs.

And some of these things I have to say, will direct attention to the MILC Program.

The Dairy Export Incentive Program, and some of this we have heard, over and over, and I will be brief and go through it in a hurry. Still has 11,000 tons of butterfat left for export. This has caused lower prices to dairy farmers and because of that, the MILC Program cost has gone up. This 11,000 tons is what is left, in spite of what was announced this morning, that I believe had been released yesterday.

If the Price Support Program is intended to floor prices at $9.90, why are prices being allowed to fall below this level? Lower price support levels create instability and in return again, add costs to the MILC Program.

Passage of H.R. 1160 and S. 560 could prevent the loss of another $800 million or more in dairy farmer income in 2003. Last year imports of MPC and casein, cost dairy farmers about 48 cents per hundred. Which again, lowers farm price and again adds to the cost of the MILC Program. Dairy farmer efforts to balance supply with demand, will fail if we do not have the help of you and others on House bill 1160 and Senate bill 560.

The Federal Order System is still needed to set minimum prices. This protects dairy farmer income from the negotiating powers of mega-retailers and marketers. Otherwise groups of dairy farmers, will underbid one another for market share, which will result in lower prices and once again, greater MILC prices.

The recent changes in the butter powder tilt by the Secretary, lowered the floor price on powder to 80 cents, hurting the all dairymen across the country. The harm especially was done in the Southeast, and particularly in the Carolinas and Virginia. Rumors of another tilt by the Secretary persists, meaning lower paid price and once again, more cost to the MILC Program.

USDA must comply with its charge and fully inspect foreign plants that are exporting to the United States. This will ensure food safety and product quality to the American consumer.

The MILC Program is vitally important and the preservation of the thousands and thousands of small and average sized dairy's in the Southeast and across the country.

If attention is given to the programs already in place, these programs can help on farm prices and again lower the costs of the MILC Program, and allow most farmers to continue in business through the summer months and into fall. Should a market recovery not occur during this time, I would expect many of the dairymen, will exit the business to salvage the remaining equity in their farms.

In our society we value open space. We value green space. We maintain parks and wilderness areas, National parks, State parks, city parks, in the interest of green space. Would it not be logical to look at our thousands and thousands of dairy farms across America, and particularly in the Southeast, where we are crowded by urban sprawl as a logical way of maintaining open green space, among the urban sprawl.

In so doing, we justify the MILC Program, for partial relief to farmers and even could be viewed as a social program. We can't stop the evolving development of dairy in the West, or the slow decline in the East. But with sound agricultural policy, we can preside over gradual change in production patterns, and over the decades, and over generations of dairy farmers, by eliminating the shock to the sudden loss of a way of life, as well as a loss of economic activity in our rural communities.

If we do not take care of our dairy industry with sound policy, that addresses the issues in a rational way, the New Zealanders, the Australians, and the Europeans will take care of it for us. Thank you.

[The prepared statement of Mr. Grove appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Grove. And Mr. Hoover.

STATEMENT OF GORDON B. HOOVER, DAIRY PRODUCER, GAP, PA

Mr. HOOVER. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittee, thank you for inviting me to speak on behalf of the Northeast Dairy Producers about the state of the U.S. dairy industry. While I am speaking primarily as a Northeast dairy farmer, my remarks will also reflect the fact that I serve on the corporate board of Land O'Lakes, a farmer-owned cooperative that markets milk for 6,000 dairy farmers nationwide. My insight into the dairy industry, and its infrastructure, and the trends facing the industry have been greatly enhanced by my involvement in the Land O'Lakes and other producer organizations.

My name is Gordon Hoover, and I am a dairy producer from Gap, Pennsylvania, just outside of Lancaster and in the heart of the Amish country. I milk 120 cows on my farm, which has been in my family for three generations. As an extension of my dairy business, I serve on several leadership roles, including Land O'Lakes Dairy committee chairman, National Milk Producers Federation Board, Pennsylvania Dairy Stakeholders and the Professional Dairy Managers of Pennsylvania.

Through my involvement in these organizations, I have seen the mood of my fellow dairy farmers change drastically in the past several years as we have learned to deal with dramatic price swings and market volatility.

Eighteen months ago, the price I received for my milk dropped 34 percent, and it stayed there ever since. In Pennsylvania, the average cost production for the first 3 months of 2003, was $13.50. Last month's on-farm milk price was $12.50. The price that we receive for our milk isn't even covering our costs.

Right now, there is a lot of depression and an apathy among dairy farmers. My neighbors have maxed out their credit lines and taken off-farm employment just to make ends meet. And that is with the supplemental milk payments we receive through the USDA's Milk Income Loss Contracts. With conditions as drastic as they are, it is more important now than ever that producers and the dairy industry work together.

In the Northeast, the milk supply is stagnant to decreasing. According to Sparks Commodities Companies reporting, we have experienced a 2 percent decline in 2001, followed by a 1.5 percent increase in 2002, and a projected 1 percent decrease this year. My concern as a dairy farmer is this: Where will the milk come from in the future to meet industry needs in our region?

As producers continue to exit the business, or to relocate out of the region due to declining profitability and other issues, fluid milk customers and other Northeast processors who make cheese, butter, ice cream and chocolate lose their milk supply. These customers need a stable supply for their processing facilities, or they will relocate to other viable dairy regions in this country, or elsewhere in the world.

The Government's involvement in shaping dairy policy should attempt to ensure that all U.S. dairy farmers receive an accurate and realistic signals from the marketplace. Programs like the dairy price support program and the MILC payments have been beneficial in helping producers maintain profitability and limit their

vulnerability to milk price volatility. However, it is unrealistic to expect that we can sustain prices at a level that encourages surplus milk production.

That is why programs like USDA's Dairy Options Pilot Program are valuable in educating producers on protecting their operations in times when milk price responds to an excess supply or drops in demand. These long periods of low milk prices, like the one producers currently face, are just too damaging not to think about risk management options.

Another key factor in increasing milk prices must include finding ways to increase demand for milk and dairy products. I support the producer-funded efforts of the National Dairy Board, Dairy Management, Inc., and the various State and regional milk promotion organizations. I urge USDA to implement the provision included in the farm bill that requires importers of dairy products, to pay their fair share for dairy promotion.

With 120 cows in my herd, I am one of the producers who benefits from the MILC payments authorized in the 2002 farm bill. These payments do help in period of low milk prices. And any small or medium size farmers would have already been out of business, if it were not for these payments.

Unfortunately, producers who milk more than 200 cows feel abandoned and left to bear the brunt of low milk prices without any significant assistance from the programs restrictions—because of the programs restrictions.

Although the MILC Program has proven to be an important safety net for many dairy farmers, I feel that the Dairy Support Program is the bedrock of the Federal Dairy Program. When we went through the last farm bill debate, this was something that all dairy farmers could agree on. However, implementation of the program does need some refinements. Through an internal survey, National Milk Producers found out that CCC needs to increase the price of purchased dairy products, particularly cheese, to assure that the program supports producer prices at no less than $9.90 a hundredweight.

I do want to commend the Federal Government on its implementation of the Dairy Export Incentive Program. DEIP continues to be one of the most effective ways to combat foreign subsidies that distort the world market for dairy products. It provides an opportunity for the U.S. dairy industry to target export markets for our products.

It is my belief that the U.S. goal in negotiating new trade agreements should be to achieve a dramatic reduction in export subsidies on dairy products, and to eliminate trade barriers.

However, as a dairy farmer, I am opposed in negotiating a free trade agreement with Australia or New Zealand. For the simple reason, that such an agreement would be a one-way street for dairy. Instead the administration should focus its efforts on negotiating a comprehensive multilateral agreement in the WTO. In that forum, dairy farmers have a reasonable hope of gaining new markets.

That said, I support passage of H.R. 1160, which would establish new tariffs on MPC imports. This bill would impose a new tariff rate on MPC imports and close the MPC loophole. Getting this leg-

islation passed, is part of a three-prong strategy to address MPC. Through this strategy, we hope to prevent MPC from further displacing domestic supplies.

Again, I thank you for the opportunity to testify before your subcommittee today. From my testimony, you may think there is a lot of doom and gloom out there in the dairy industry. But from my perspective, there is a lot of hope too. Dairy farmers are eternal optimists. We love what we do, despite the hardships we face. Within our industry, we have come a long way in realizing we need to take more responsibility in shaping our future.

An example of our cooperative efforts, is the first ever industry led program to balance supply and demand, without any Government involvement. Cooperatives Working Together or CWT, is a farmer funded, self-help program, proposed by National Milk, has the support from 31 U.S. cooperatives, and is indicative of how far we have come in working together as an industry to control our destiny.

In addition to cooperative efforts like CWT, we will continue to need your help and support. As I said earlier, programs like the Dairy Price Support Program and the DEIP Program are working to benefit producers, and we need you to continue to give them your continued support. We also need you to continue to keep the farmer's best interests in mind, when developing legislation that affects dairy trade obligations, environmental restrictions and income subsidies. Our goal as dairy farmers, and as an industry, is to create a marketplace where supply and demand work together to generate reasonable and realistic profits for producers, without substantial dependence on Government subsidies. Anything you can do to help us to build and sustain that marketplace, is greatly appreciated. I thank you very much.

[The prepared statement of Mr. Hoover appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Well thank you, Mr. Hoover. And let me just say to the entire panel, this testimony has been excellent. We heard from the farm economist's earlier, but in many respects, you do an equally as good a job of explaining the problems in the dairy industry as they did, and in some respects, in a much more understandable way. So we all thank you, and we appreciate your being here.

Mr. Rowekamp, you mentioned, and one of my concerns in my opening statement was how much we have seen in terms of a decline in overall dairy production, numbers of herds and so forth, in the State of Minnesota. And you said you were attempting to expand your dairy operations in Minnesota, and you alluded to the fact that you are encountering some problems. Would you talk about that for just a minute?

Mr. ROWEKAMP. Yes, I would appreciate talking about it. As I said in my testimony, we are going through the permitting process to build a 2,500 cow dairy right now. Some of the problems that we have encountered, really they don't involve following the rules that MPC has set up, and the State has set up.

Most of the problem comes in at the local level. And the problems that we have encountered, is local opposition to the dairy. It is, I don't know if there is an acronym for these people, its not in my

backyard, or something like that. But a lot of this local opposition has been initiated by some environmental groups. One in particular, and what these groups do, or this group, when a feed lot is proposed and it could be hogs or dairy. They will come into the area and go door-to-door, and pass out information, saying how bad this feed lot is going to be, otherwise going to destroy the economy of the community and on and on. And people get concerned, they get worried about it, and that is where the opposition starts. And what we have done is we stopped our permitting process, and two townships set up a review board, and they have been going through all of these concerns for about the past, I think it is going on 16 weeks now. And they are coming to a conclusion, they should conclude their process in June, we are hoping. And from there, from whatever their recommendation is, then we will move forward.

Mr. GUTKNECHT. Do these groups understand for example, the use of anaerobic digesters, and what that ultimately will do in terms of reducing the amount of potential odor that is coming from that facility?

Mr. ROWEKAMP. I think they fully understand what the anaerobic digestion process is and the reduction of odor, the reduction of pathogens and other stuff that digesters do. Create green energy from a renewable resource. They are very aware of this. What their agenda is and this is not only my opinion, they do not want to see large farms.

Mr. GUTKNECHT. Don't confuse me with the facts, we have already made up our mind.

Mr. ROWEKAMP. Yes, yes.

Mr. GUTKNECHT. I want to get back to Mr. Boehning, because you talked about something that really is hot of an issue in the committee and in the Congress, and that is the issue of milk protein concentrates. I would have you talk a little bit about that, because one thing we know is that there is a market here in the United States for milk protein concentrates. And you are involved in a co-op in your region, that is actually going to start producing those. Do you see this as a market opportunity or well, I'll just leave it open ended. Tell us about milk protein concentrates in the co-op that you are involved with?

Mr. BOEHNING. I definitely view it as a market opportunity, because with MPC, if we don't get started making it ourselves, and get involved in the business of making it, we will never be able to, even if the tariff situation was corrected, we wouldn't have the technology or you to go forward with MPC production and manufacturing. So I definitely view it as an opportunity and I hope to see more interest, and more plants being looked at.

Mr. GUTKNECHT. Can you tell the committee how many pounds do you expect to produce in that plant, do you know?

Mr. BOEHNING. Yes, if I can find it.

Mr. GUTKNECHT. Well maybe what we have.

Mr. BOEHNING. I found it here. The plan is capable of receiving and processing 5 million pounds of raw milk per day. Let us see, it also produces some nonfat dry powder, cream, and other dairy ingredients. That is about all I have on it.

Mr. GUTKNECHT. Well we will try to find out, because we are very interested in what is happening down there in New Mexico

and hopefully, some other groups will come together and look at the same opportunity.

My time has expired, the gentleman from California, Mr. Dooley.

Mr. DOOLEY. Thank you, Mr. Chairman.

First off I want to once again thank Dr. Brown and Dr. Cropp for the great work that you did. And I apologize to you, I interchanged you at one point, and I didn't intend to do that.

And I would also ask the panelists. If you have the opportunity to read Dr. Brown's analysis that he did in conjunction with FAPRI? It is really interesting, because they did an analysis in terms of what would happen to milk prices over the next decade, if you didn't have the milk program in place, the Milk Loss Program. If you had it as without the caps on it, in terms of production. They also go further, and do an analysis in terms of what would be the impacts on producer prices, if you did away with the Federal orders entirely, as well as the purchase program. And what is fairly remarkable, is after you get over the first 2 years, you actually see minimum impacts on prices, in terms of if the market does work and it does adjust.

And I guess what has been a little bit frustrating to me, and some of the prior panels is, you know we have had a lot of people talking about charts, putting charts up on the easels and what not. But no one has put up a chart that really showed a deviation that would be from what we would expect in terms of supply and demand and prices.

I mean there is a lot of frustration out there that maybe USDA ought to be doing more, but there is a limited amount that USDA can do to overcome, and over supply in terms of what the marketplace is dictating now. And I think that is the challenge we face here, and I would hope that some of the groups in the production industry would really try to take an objective overview of this. I have become somewhat familiar with the Cooperatives Working Together Program, and I think anything that brings the cooperatives together is an interesting approach.

I guess though, when I look at it though, I wonder if it is not just another band-aid. It is a 12 month program supposedly, it is going to have an 18 cent a hundredweight deduction, which for an average herd, the 1,000 cow herd in my district, would mean that producer would be contributing $42,000 a year to this program, that is supposedly on the promise if they are going to see an increase in a dollar in production.

In one of the components of it is you are going to have a herd reduction of 125,000 cows. Well that is 1.3 percent of the 9.2 million head we have out there now. You can expect that you would see that 125,000 wouldn't be the most productive cows that are out there, it would be the least productive cows, so you are going to have maybe a producer response on that, and a production response of less than 1 percent. And we are spending a lot of money on this out there, how do you guys really expect this thing to work? And you know Chuck, why would you be in one contributing $42,000 to a program on a promise, by this reduction in herd size nationally of a very insignificant amount is going to result in that significant of a price response?

Mr. AHLEM. Well I think the reality, I support the voluntary process, whether short-term or long-term. If the industry felt that was an appropriate way to steer, I would support it. I think it is probably a band-aid approach, I think the market is going to work eventually, but I think the industry has to grab, put its teeth into something, to try to move away from the mentality that hey, we can help ourselves, we don't need the Government to fool around in our marketplace all the time.

And I think through this process, we will start learning what works, and what doesn't. It doesn't cost us anything, if the Government does it. If it doesn't work generally I mean, at least we can get some more dollars for another disaster program or something else to feed me. I think those dollars ought to be spent in dealing with some of the issues, where he wants to be a more efficient dairymen and grow, help with the plumbing, the infrastructure, dealing with some of the regulatory burden it has put upon us. Those are the long-term economic issues that we are going to be dealing with. Dealing with that infrastructure, and the bureaucracy.

I served on the regional water board for California's Central Valley for 4 years. I understand what the regulatory process is and those burdens, and some of the solutions that are going to need to be put out there. And those are going to cost an awful lot of dollars for us to continue going, and to become the kind of efficient suppliers that we want to be.

Mr. DOOLEY. I would like to, Mr. Hoover, maybe a response from you. We have the cooperatives that are coming together to generate this fund which is projected from some figures. I know they are all preliminary, maybe $250 million in terms of trying to deal with some of the supply challenges.

You know we also have this same industry that said, that they don't have the financial where with it all to be competitive with milk protein concentrates, in terms of have been reluctant in the past to invest in the infrastructure to be you know, to respond to this consumer demand. Why are we using this $250 million, why hasn't that been available by the co-ops to invest in meeting a consumer demand in the past years. Because the Land O'Lakes itself, has been a purchaser of imported milk protein concentrates. So you acknowledge there is a need for these, and they are different than powder because, Lord knows we have got enough powder in the country. So you know, why are we dedicating some of these same resources to, you know in terms of meeting consumer demand?

Mr. HOOVER. Well thank you. We do dedicate quite a few dollars from the dairy, from the producers side of the industry, and to advertising and creating more demand through the National Dairy Board and those programs. Land O'Lakes as well as many other cooperatives have brand names that they support, and try to get more demand created in the industry.

That is a limited amount, I mean we can only create so much demand that we are putting as many dollars as we can afford against it. One of the theories, purposes behind the CWT Program, is this is an area on the production side, that we can affect. We have 100 percent control on it, whereas many of our other programs, are out of our direct control. Many of them like the previous Herd Buyout

Program, the Diversion Program, some of those programs. Even the MILC Payment basically, was devised within these walls, and it wasn't you know, on the forefront of the whole farm bill agenda, and it kind of came about the 9th hour. You know like a lot of other programs, and a lot of people in the country, it was free money, and it was at a time when we needed it so we accepted it.

But again, that was an area that realistically, you fellows had more control over that program, than we actually did as producers.

Mr. DOOLEY. I didn't, it wouldn't have happened.

Mr. HOOVER. You know, so the real thrust of the CWT Program, is that farmers can take a direct response to their market, by controlling the production side. You know, it is the only area, that we can have a direct control over, we can have a direct affect and control our own destiny.

Agricultural commodities have been given the power of the Capper-Voltsead Act, and we have never utilized that. And so this is an opportunity, where we are trying to utilize that power we have, to manage our own market. And it is one of the few times, this is the closest we have ever gotten to doing it, in this large a scale.

So that is the real drive behind it. We spent a lot of dollars on the demand side, and this is our attempt to manage the supply side.

Mr. GUTKNECHT. Well thank you, Mr. Hoover. And I will just say from my perspective, I hope it works. I mean we just have to wait and see, but anyway. The gentleman from Michigan, Mr. Smith.

Mr. SMITH. Mr. Chairman. So put up with some of my curiosity questions. Life was just so much easier after we sold the cattle.

Mr. GUTKNECHT. It isn't like that in the dairy business.

Mr. SMITH. Then I go down the line and give me roughly the percentage of the feed that you might grow on the farm operation, to feed the cattle. Just sort of a round to round figure.

Mr. ROWEKAMP. All the feed I grow goes through my cows.

Mr. SMITH. No, no, what percentage of the feed needs is grown on the farm? What is grown on your land that you own?

Mr. ROWEKAMP. All of it.

Mr. SMITH. So you will be able to accommodate a 100 percent of the feed needs for that 235 head?

Mr. ROWEKAMP. I will be able to accommodate all of the roughages, and the greens. I do buy soybean, meal cottonseed, beet pulp, pellets, some commodity products to mix into the ration, but all of the roughages and greens are grown on the farm.

Mr. SMITH. And Chuck, California doesn't do that, do they?

Mr. AHLEM. No I actually grow all of the silage's that I feed my cows, the alfalfa, hay, corn, byproducts, an awful lot of byproducts we feed, that used to be a burden on it.

Mr. SMITH. I am just trying to get a little bit of a feel.

Mr. AHLEM. I probably raise 20 percent of my feed actually of the total ration.

Mr. SMITH. I am trying to get a little feel for how the other farm programs play into the whole dairy situation. Those that grow their feed are eligible for some of the support price that we have on the greens. Those that don't grow their feed, probably experience a little lower price, because of the Federal Farm Programs for that corn. Mr. Boehning.

Mr. BOEHNING. We grow probably 35 percent of the total feed fed, which all of that is on the forage side of the ration.

Mr. SMITH. Mr. Grove.

Mr. GROVE. We grow all of the forages that are fed, none of the concentrates. There is an ongoing argument in our area by some, that you can buy those feeds cheaper than you can grown them, so it is an ongoing debate, I think the issue what percent you grow, is not an indication of efficiency. But we do grow all of the forages, and buy the concentrates.

Mr. SMITH. I mean some years there is no question, it would be cheaper to buy them. Mr. Hoover.

Mr. HOOVER. We are the same scenario, we raise all of our own forages, and buy all of our concentrates.

Mr. SMITH. Tell me about your plans to participate in the EQUIP Program, and any suggestions you have on the EQUIP. Let us just go down the line again.

Mr. ROWEKAMP. As of right now, we have got our farm pretty well in compliance with all of the conservation. It is all contoured, waterways and everything. And in Minnesota the EQUIP Program will not put any money into new facilities. They want to use all of that money to upgrade existing facilities. So I won't be using any of that.

Mr. SMITH. So the State's conservationist has that latitude of making that decision that they can't use any of the money?

Mr. ROWEKAMP. Yes.

Mr. SMITH. I know they had a payment limit authority, as far as you couldn't receive more than $100,000 without the approval of the conservationist. Chuck.

Mr. AHLEM. Well we just in the last week to see what kind of monies were available, and in Merced County we have, I think there is a $1 million, which is not enough money to do virtually anything, when you spread it out. I think they said they had something like 200 applicants. I think the EQUIP Program's concepts is a great idea, we just need to get more dollars, to shift these dollars into that type of a program.

Mr. SMITH. I mean by and large, farmers were complaining that the $450,000 that is in the farm bill, that they are probably not going to get because of all of the applicants.

Mr. AHLEM. We also have the air side. So part of the money is going into looking at the air pollution side. And that is a whole issue we have in the valley, as far as dealing with some of the air quality issues.

Mr. SMITH. Brian.

Mr. BOEHNING. I am just now looking into it, but I will probably apply for a small update on my waste water system, through the livestock EQUIP, and then I will probably also apply for some help on lowering the drops on some center pivots on the farm side.

Mr. SMITH. Mr. Grove.

Mr. GROVE. We have participated in the past with a number of issues. The rotational grazing, lots, and the fencing of the streams and probably to an extent, that we are pretty well where we need to be, and probably will not participate at a great level from here on.

Mr. SMITH. Mr. Hoover.

Mr. HOOVER. Our farm is in compliance with most areas of those programs. We have the same scenario at our county, that there is more applicants, than dollars to go around. So again it is a program that is of good design, can help a lot of farmers, but there is just not near enough dollars to go around.

Mr. SMITH. It was sort of, at least it was my view on it. And it was sort of a compromise on the whole CAFO Program and the intrusion of the law there, versus trying to help farmers sort of give in and build up the best possible system. Thank you, Mr. Chairman.

Mr. GUTKNECHT. Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. Earlier today we have had an ongoing discussion regarding whether or not the importation of milk protein concentrate is impacting the dairy industries prices, essentially. And I would just like to get a quick answer, whether you think it is, whether you think it is not. I know in some of your testimony, you did indicate it. But I would like a quick answer, from all of the panel, so that we can get a better feel for those of you who are actually producers, versus some of the folks who are not producers. So I think we can start with Mr. Rowekamp, please.

Mr. ROWEKAMP. Well like I said in my testimony, I don't think it is the total reason why prices are low, but it does impact prices somewhat.

Mr. NUNES. Mr. Ahlem.

Mr. AHLEM. Sure, it has an impact, but we do export products. And I think realistically, this is my short answer because I didn't include it in the testimony, that you know I think we need to look at opening these markets realistically, to add a tariff on that isn't in good faith, and this period of negotiations. And we really need to look at opening other opportunities, other markets when we negotiate defreighting figures.

Mr. NUNES. So you are not in favor of H.R. 1160?

Mr. AHLEM. No, I am in favor of letting the market work, and let us develop some marketplace for our MPC, here in this country.

Mr. NUNES. Mr. Boehning.

Mr. BOEHNING. I am in favor of H.R. 1160. I feel like it is, while we are developing a product here in the United States, we do need some help closing the door on imports or at least holding them to current levels, while we are developing these plants like, that I have eluded to earlier. And I feel like it is you know, part of the problem you know with low milk prices, but definitely not, you know there are several other factors that we have talked about also.

Mr. NUNES. Do you know when your plant, or the DFA plant is going to come into production?

Mr. BOEHNING. It I believe, December 1 it did come onto production.

Mr. NUNES. Well it has already?

Mr. BOEHNING. It has had some, it had some breakdowns at first, and it is kind of getting off to a slow start, being up to full capacity. But it is producing MPC, I believe.

Mr. NUNES. Thank you.

Mr. GROVE. Could I comment?

Mr. NUNES. Sure, sure.

Mr. GROVE. One of the problems that plant has been used as a balancing plant, and there is so much milk in the Southwest coming that way to turn into powder, that we have actually had trouble you might say, slowing down that powder conversion to get into the MPC business. Bu the test runs have been made, and we are operating the plant as an MPC plant partially, today. But that is a critical balancing operation in the Southwest milk supply. And they are covered with milk.

Mr. BOEHNING. I guess currently it is trying to do both, make MPC and balance the milk supply on producing powder also, so they are trying to give time to both, at that plant.

Mr. NUNES. OK, I think we need to at some point, Mr. Chairman, we need to maybe investigate this new technology that is being developed to produce MPC's here in this country. I know that you have every intention of doing that but——

Mr. GUTKNECHT. Well yes, and we are starting to sort of try to get our arms around just how big a problem this is, and what the real solution is long-term. This testimony today has been helpful, but we need to learn a little bit more.

I for example, was interested in the testimony earlier by the economist, and there seemed to be some disagreement exactly, how much cheese we import every year. It strikes me, that we ought to be able to get at least a definitive answer to that question. You get back to the issue of milk protein concentrate. When we first heard discussions about this, there were cooperatives who promised that they were not using them, subsequently, we learned that they in fact were, and so sometimes we had it, and that is why I said at the opening of this hearing, facts are stubborn things, and what we really want to do, is get the facts.

Mr. NUNES. Yes, and that is what we are trying to do here, but I think we do need to at some point, explore these new, and we need to get an understanding of what exactly these plants are doing, and how or if, they can be competitive against the EU, or Australia and New Zealand.

Mr. Grove, I notice you are from Virginia, I forget, are you part of the Federal order, or are you a State order, I can't remember. And could you explain that.

Mr. GROVE. We operate——

Mr. NUNES. Briefly, I know it is difficult.

Mr. GROVE. We have a State Milk Commission, perhaps the last one in the country, that sets a minimum price on milk. And I guess you would say it is a unique system. Again, it is the only one, the only one left I believe. A number of those have been——

Mr. NUNES. So you are not in the Federal order?

Mr. GROVE. Well we are under the State Milk Commission and of course if our product leaves and goes into an order, we would participate, where we market. If we market into an order, we participate.

Mr. NUNES. Right. OK, thank you. Thank you, Mr. Chairman. I am out of time.

Mr. GUTKNECHT. We are going to, if you don't mind, and I know this hearing is going on much longer than we ever anticipated, but you have come in from a long ways. And if you wouldn't mind

sticking around for a little bit longer, to allow for another round. I know that Mr. Dooley would like to ask a few more questions, and Mr. Smith would like to ask a few questions, if it would be alright with you, we would go to another round of questions. With that, I will recognize the gentleman from California, Mr. Dooley.

Mr. DOOLEY. I want to hear from you in terms of your support or opposition to an extension of the forward contracting provisions that we had. That a number of years ago, we passed legislation that would allow for forward contracting, on a voluntary basis that would allow those producers that sell to proprietary companies the same options, that basically are now available for co-ops. And I was wondering if this was something that you know you folks, any of you have participated in, or if any of you have any opposition to an extension of this, I would like to hear your reasons why.

Mr. ROWEKAMP. I just recently participated in it this last few months. I have been marketing my milk on the Chicago Board of Trade for about 4 years now, and I did it more or less just to use the program. I mean it was there, it saved me some money basically. To extend the program I think my recommendation would only be to extend it to educate producers on how to use what is and stuff, I wouldn't say necessarily we need to extend that to subsidize their margins or their cost of the put. I think it is a good tool, I think it did educate some producers. I know up in our area, the co-op that I sell to, there are still not enough producers, it is only like 5 percent or something like that, that do use the futures.

Mr. DOOLEY. And in terms of being able to enter into a contract with the proprietary company, in terms of contracting, locking in a price, you would have no objections to that either?

Mr. ROWEKAMP. I don't quite understand the question.

Mr. DOOLEY. I mean that is essentially, you know there are two different programs here. There is one which was dealing with the options in the pits, and there was another that allowed you to enter into a voluntary contract at a set price, that would be negotiated and would keep the pool hold too, that would allow you to manage some of the volatility in prices.

Mr. GUTKNECHT. I think I understand the question. Currently the co-ops have the ability to forward contract with producers, for-profit processors do not. I think his question was: Would you have any objection if for-profits were included in the option of allowing people to forward contract with those processors?

Mr. ROWEKAMP. No I wouldn't have any problem with that.

Mr. DOOLEY. Yes, well the private. Does anyone else, Mr. Ahlem?

Mr. AHLEM. I definitely support the opportunity to lock in my market for a period of time, or at least take a segment of that opportunity, of that market, where I know I can make money and look at the different markets for different opportunities, you know want to bet on future higher markets, you go to the put option and go that way. But I think it is just another management tool, that we ought to be able to use, and unfortunately, we can't as we are shipping to a processor at this point.

Mr. BOEHNING. I have been involved with the futures for 3 years with forward contracting. But I don't necessarily feel that the Government should have to promote it. I feel like it is an economic decision on the producers, you know just like forward contracting

feed, or not you know that it should be entirely up to the producer, whether to use it or not.

Mr. DOOLEY. Mr. Grove.

Mr. GROVE. I think to try to beat the market is risky, and probably impossible. I would suggest that if you can lock in a price that you can live with, that is the way to have a price you can live with. I met a dairyman in Florida, some years ago, well 2 years ago at a National Meeting. He was from Idaho. And he had locked in forward contracted his milk, and locked it in. And we were getting tremendous prices, good prices for our milk at that time, and he informed me that his wife hadn't spoke to him for 6 months. I mean there are some risks involved there too. And there are some levels of sophistication involved, when you really get deep into the countryside so to speak, I question on a broad basis the opportunity here for a majority of the dairymen.

Mr. DOOLEY. Mr. Hoover, do you have any comments?

Mr. HOOVER. My only comment would be that there was some experience with the integrity of the program, when I came to the relationship between the producer and the company that he was forward contracting with, you know that is one thing we want to try to avoid, although you know that is a relationship that I don't think we need the Government to get involved with a whole lot. But I think the opportunity to manage your price is something that should be available to everybody.

Mr. DOOLEY. Well I appreciate all of your comments, and I would hope that you would communicate to the National Milk Producers Federation, who has sent up a letter in opposition to allowing us to extend this program. That it does nothing more than allows a dairy producer to voluntarily, on his own you know cognizant, to enter into a contract with the proprietary company. And as much as any dairy producer is part of a co-op today, to do the same thing with their co-op. And as a farmer myself, I find it difficult that we have one of the national organizations, supposedly representing producers out there that would preclude a risk management tool from being available to producers who choose to market, to a proprietary or private company.

Mr. GUTKNECHT. Mr. Smith.

Mr. SMITH. To maybe Mr. Ahlem and Mr. Boehning. Do you grow your replacements?

Mr. AHLEM. Yes, I grow 100 percent of my replacements now. I have previously, have bought an awful lot of animals, most of them were bought in Maine and New Hampshire, supporting that program over there.

Mr. BOEHNING. I have always grown 100 percent of my replacements.

Mr. SMITH. No, but will 100 percent of your replacements accommodate maintaining your herd size?

Mr. BOEHNING. Yes, they will more than accommodate it.

Mr. SMITH. I mean around to us, and I was wondering if it is a national problem. Some of the big herds coming in three times a day, milking, and BST. The productive life of the cow is 3 and 4 years, and now they are having a big problem in the price of heifer calves and heifer replacements have just sky rocketed, and I was wondering if that is sort of a National problem?

Mr. BOEHNING. I feel like if a person does a good job of raising their calves, and has a good replacement program, that he can raise more than enough you know, replacement cattle as long as his co-rate, you know stays within reason, say 25 to 35 percent of his herd a year or something.

Mr. SMITH. So what would the average production life of one of your cows be?

Mr. BOEHNING. On my farm it would be 4 years, but a lot of the farms in my area, it is probably about 3 years.

Mr. AHLEM. And we are looking to much the same, you have co-rates of some folks that are doing, culling 35 to 40 percent a year. We cull about 22 percent, so we can actually show some pretty substantial growth with a very good cattle raising program. It all depends on what kind of losses. One producer can raise 10 percent, and lose 10 percent and the other one could lose 50 percent pretty easily.

Mr. SMITH. I am assuming, Mr. Hoover and Mr. Grove, probably have a couple to sell?

Mr. GROVE. No, we don't have any to sell, but we do maintain our numbers, on that productive life you mentioned. I think there are some areas of the country, hot weather country, the Southeast. Deep in the deep South, there are some of those areas where they breed those heifers back once or twice, and if they don't catch, they are not bred back. There are herds, I would dare say where 2 to 3 years, would be a productive life. Not in my area, but further South, they are not. Again, in hot weather areas.

Mr. SMITH. Is BST a recommended farm management practice, for dairy farmers?

Mr. GROVE. It has been somewhat controversial, but I use it.

Mr. HOOVER. It is a tool that is out there like artificial insemination, better feeding practices that is available to farmers if they choose to use it.

Mr. SMITH. I think we sort of passed over the negative parts of it, at least that is my impression.

Mr. HOOVER. I used it, but my son about a year ago, thought he could do a better job not using it, so you know who won.

Mr. SMITH. Anyway, I want to add my thanks gentlemen, to you being able to find somebody to milk the cows while you are here and thank you for being here. Mr. Ahlem.

Mr. AHLEM. Can I make a short comment? One thing we didn't cover, is any of the outbreak issues. Being in California, we have had the poultry issue with an outbreak, where we have got 60 percent of the USDA field staff, about 80 percent of the California field staff tied up on this outbreak. I don't know what would happen if we had a foot and mouth or a BSE issue, I would certainly like to see more dollars go into the kind of rapid testing programs, so we can if we do get something, we can get our arms around it and deal with it. The USDA and the CDFA has done a very good job dealing with some of these initial impacts, and some of the outbreaks from Brucellosis in New Castle and they weren't getting a great deal of experience, but all of this discussion is beside the point. If we get an outbreak of any magnitude in the U.S. So if we can keep that on our minds.

Mr. SMITH. Good point.

Mr. ROWEKAMP. Could I just add onto that a little bit? I think along with that, you know the possibility of outbreaks and stuff, in order to if we ever forget we never will have one, but I think implementing a national I.D. system would help get our arms around, if we ever did have an outbreak.

Mr. SMITH. I heard the estimates from $4 an animal to $40 an animal.

Mr. AHLEM. Actually I am working with a system now, just in the early stages, they have actually started production where they can, for $2.50 can put an I.D. where you can read 32 pages of information into that I.D. So the cost of some of these I.D.'s is getting down, and I think there is going to be several systems that work, where that animal will actually carry that information with it.

Mr. SMITH. Bill just came back from Canada, and they are very upset by the country of origin labeling with a lot of the cattle going back and forth. I am not sure how many, if anybody has really, I guess you are not that close to the Canadian border, but it is this country of origin labeling for a lot of our food products is going to be tremendous task too. Gentlemen, thank you very much.

Mr. GUTKNECHT. Thank you. This makes an interesting segway, I was just handed a statement from Secretary Veneman, that there appears to have been an outbreak, or at least an isolated case of BSE in Canada. It was just announced today. And so we have been very fortunate here in the United States. We don't know enough about the situation yet, but it is the first example, that we know of in Canada. So interesting segway, when you ask that question.

Let me add my thanks again, to all of you, and all of the witnesses who appeared before us today. This has been an incredibly informative hearing. We appreciate your coming from long distances to join us and be with us today. Let me also say thank you to the staff, for helping to put this together. I think this has been a very, very good hearing, and hopefully, it is the beginning of the process of trying to get our arms around exactly what is happening in the dairy industry.

As I said at the beginning, I think most of us have a special place in our heart for dairy producers. The folks who actually meet those cows at least twice a day, 365 days a year.

Without objection, the record of today's hearing will remain open for 10 days, to receive additional material and supplementary written responses from witnesses, to any questions posed by a member of this panel.

This hearing on the Subcommittee on Department Operations, Oversight, Nutrition, and Forestry is adjourned.

[Whereupon, at 2:35 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF GORDON HOOVER

Chairman Gutknecht and members of the subcommittee, thank you for inviting me to speak on behalf of Northeast dairy producers about the state of the U.S. dairy industry. While I am speaking primarily as a Northeast dairy farmer, my remarks also reflect the fact that I serve on the corporate board of Land O'Lakes, a farmer-owned cooperative that markets milk for 6,000 dairy farmers nationwide. My insight into the dairy industry, its infrastructure and the trends facing the industry has been greatly enhanced by my involvement in Land O'Lakes and other dairy producer organizations.

My name is Gordon Hoover, and I am a dairy producer from Gap, Pennsylvania, just outside of Lancaster and in the heart of Amish country. I milk 120 cows on my farm, which has been in my family for three generations. My farm is slightly larger than the average herd size in Pennsylvania, which is right around 75 cows, and my milk is typically sold to Hershey Foods to use as an ingredient in chocolate. As an extension of my dairy business, I serve in several leadership roles, including Land O'Lakes Dairy Committee chair, National Milk Producers Federation board member and as a member of the Pennsylvania Dairy Stakeholders and Professional Dairy Managers of Pennsylvania.

Through my involvement in these organizations, I have seen the mood of my fellow dairy farmers change drastically in the past several years as we've learned to deal with dramatic milk price swings and market volatility. Eighteen months ago, the price I received for my milk dropped 34 percent, and it has stayed there ever since. In Pennsylvania, the average cost of production for the first three months of 2003 was $13.15 per hundredweight, and last month's on-farm milk price was $12.50 per hundredweight. That means that the average price producers receive for our milk isn't even covering our costs to produce it.

Right now, there's a lot of depression and apathy among dairy farmers. My neighbors have maxed out their lines of credit and taken off-farm employment just to make ends meet. And, that's with the supplemental payments we receive through the USDA's Milk Income Loss Contracts. With conditions as drastic as they are, it's more important now than ever that producers and the dairy industry work together.

As a dairy farmer, I believe in the cooperative spirit, working together with other producers, through industry organizations, within our cooperatives like Land O'Lakes, and with government officials, to continually improve our industry and increase dairy farmer profitability. That's why I've dedicated part of my time and efforts to participating in the industry organizations I listed earlier. It's through organizations like these that dairy producers shape and influence our future and our viability in the industry.

In the Northeast, the milk supply is stagnant to decreasing. with According to Sparks Commodities Companies, reporting we experienced a 2 percent decline in 2001, followed by a 1.5 percent increase in 2002 and a projected 1 percent decrease this year. My concern as a dairy farmer is this: "Where will the milk come from in the future to meet industry needs in our region?"

As producers continue to exit the business or relocate out of the region due to declining profitability and other issues, fluid milk customers and other Northeast processors who make cheese, butter, ice cream and chocolate lose their milk supply. These customers need a stable supply for their processing facilities or they will relocate to other more viable dairy regions in this country or elsewhere in the world.

I believe producers need to work together, as individuals and through our cooperatives, to assure an orderly allocation of milk to our customers in a way that optimizes the value of the milk we produce. If we don't, the dairy infrastructure in the Northeast will deteriorate as it has in other parts of the country, and those producers who haven't exited the business will have to do so because they will not have access to supplies or market outlets.

The government's involvement in shaping dairy policy should attempt to ensure that U.S. dairy farmers receive accurate and realistic signals from the marketplace. Programs like the dairy price support program and the Milk Income Loss Contracts have been beneficial in helping producers maintain profitability and limit their vulnerability to milk price volatility. However, it's unrealistic to expect that we can sustain prices at a level that encourages surplus milk production. What we want to prevent is losing a lot of good, solid dairy producers due to the low milk prices, while we wait for the economy to turn around and demand to rebound. If we do lose a substantial number of producers during this milk price slump, we could face a shortage in milk supply should demand rebound a year from now.

That's why programs like USDA's Dairy Options Pilot Program are valuable in educating producers on ways to protect their operations in times when the milk price responds to an excess supply or drops in demand, such as the situation we're in now. Since the 1990's, producers have made progress in learning how to use the futures markets as a risk management tool. Many cooperatives are being more creative in offering price protection opportunities. For instance, Land O'Lakes offers fixed price contracts to members, regardless of their size, who want to protect their incomes.

Personally, I have to do a better job at taking advantage of these opportunities. Although I participated in the Dairy Options Pilot Program, I haven't used forward contracting since then because I felt the low debt structure of my operation enabled me to weather market volatility on my own. However, long periods of low milk

prices, like the one producers currently face, are just too damaging not to think about risk management options.

Like many other producers, I still need to learn more about these programs, and I need guidance on exercising my risk management options appropriately. Providing expertise and training to producers on risk management would be an excellent way for land-grant universities and State government, as well as the USDA, to get involved in protecting the long-term viability of our Nation's dairy farmers.

Thirty-one cooperatives representing U.S. dairy farmers developed another avenue for potentially bolstering producer incomes—the proposed establishment of a voluntary, farmer-funded and industry-led program to bring supply and demand back in balance. The program, called CWT or Cooperatives Working Together, was developed by National Milk Producers Federation (NMPF) to respond to a crisis situation caused by the low milk prices.

There's a lot of skepticism in the industry about the program. But I believe it can work because we (the NMPF board and staff) put a lot of time and effort into making sure it will work. If this program fails, then the market will exercise its discipline eventually. Unfortunately, until then, many producers will be forced out of business by low milk prices. If the program does succeed, the dairy industry will have a model in place that we can quickly implement in future situations when an imbalance in supply and demand is driving low milk prices for farmers.

Another key factor in increasing milk prices must include finding ways to increase demand for milk and dairy products. I support the producer-funded efforts of the National Dairy Board, Dairy Management, Inc., and the various State and regional milk promotion organizations. This is another way that we can work together for mutual benefit, by promoting our products and conducting research on the benefits of milk and dairy products. In this regard, I would urge USDA to implement the provision included in the farm bill that requires importers of dairy products to pay their fair share for dairy promotion. The dairy promotion programs tend to increase demand for all dairy products, including imports. But, until now, importers have been free-riders of our promotion efforts. It's time for them to pay their fair share, too.

With 120 cows in my herd, I am one of the producers who benefits from the Milk Income Loss Contract payments that were authorized in the 2002 farm bill. These payments do help in periods of low milk prices. However, many good, solid producers are frustrated by some of the limitations and guidelines established by the MILC program.

The program has done what it was intended to do. Many small or medium-sized farmers would have already been out of the business if it were not for the MILC payments. Unfortunately, producers who milk more than 200 cows feel abandoned and left to bear the brunt of low milk prices without any significant assistance. Looking forward, I am concerned that, if the industry fails to take effective voluntary action to balance supply and demand now, regardless of the MILC payments, we will undermine the willingness of Congress to provide this kind of support for producers in the future.

The MILC program has proven to be an important safety net for many dairy farmers. However, I feel that the dairy price support program is the bedrock of the Federal dairy program. When we went through the last farm bill debate, this was something that all dairy farmers could agree on. Having said that, implementation of the program does need some refinements. NMPF recently did an internal survey to determine the actual cost of meeting CCC requirements for selling products to the government. They found the CCC needs to increase the purchase price of dairy products, particularly cheese, to assure that the program supports producer prices at no less than $9.90 per hundredweight.

USDA's decisions on when to implement butter/powder tilts also cause frustrations among producers. It sometimes appears that the department is exercising its authority to adjust the tilt at times when the action will have a detrimental impact on producer incomes. This seems contrary to the program's purpose, which is to establish a safety net of $9.90 for producer milk prices.

Besides dairy price support programs, the other major element of dairy policy is the Federal Milk Marketing Order system. To the extent that the Committee chooses to address marketing order issues, I strongly recommend that you bear in mind a simple statement of principle for the system: "The Federal orders exist to assure orderly marketing of milk and equitable sharing of market revenues among those producers who serve the market." It seems the most troublesome issues arise when an organization or group of producers either chooses to take advantage of an order's provisions in order to avoid equitable sharing of market revenues or seeks to exclude themselves from the order to gain a competitive advantage over other producers in the order.

Within Federal Order 1, or the Northeast, producers face similar challenges as dairy farmers in other parts of the country—escalating input costs, increasingly stringent environmental restrictions and limited access to a dependable labor force. Specifically, in Pennsylvania, producers deal with continuing pressures from urban sprawl, increasing land values and corresponding property taxes, the extensive permitting process required to expand or upgrade facilities, and discrepancies in the over-order premium structure. Organizations like the Pennsylvania Dairy Stakeholders and Pennsylvania Farm Bureau are working with State legislators and the Pennsylvania Department of Agriculture to address many of these issues in order to maintain a viable dairy industry in the State.

The discrepancies in the over-order premium structure are another issue. Over the past five years, Land O'Lakes dairy producers in the State and others have worked with the Pennsylvania Milk Marketing Board (PMMB) and State legislators to adopt a pooling regulation that would pool the Class I Over-Order Premium among all farmers in the State. The reason we feel it should be distributed among all producers is because the PMMB established the regulation to help all Pennsylvania dairy farmers better manage local market conditions, especially in times of economic hardship, and receive greater value from their milk. This is similar to the principle behind the Northeast compact. Unfortunately, under the current distribution guidelines, less than one-third of the State's dairy farmers receive nearly 85 percent of the premium proceeds. The PMMB continues to delay the outcome of that regulation, preventing the majority of Pennsylvania's dairy producers from receiving their fair share from the premium.

I do want to commend the Federal Government on its implementation of the Dairy Export Incentive Program. DEIP continues to be one of the most effective ways to combat foreign subsidies that distort the world market for dairy products. It provides an opportunity for the U.S. dairy industry to target export markets for our products. As a producer who is concerned about how we overcome foreign subsidies and build viable export markets for dairy, I strongly support using DEIP to the fullest extent allowed under WTO trade rules, and I urge full funding of DEIP by Congress.

It is my belief that the U.S. goal in negotiating new trade agreements should be to achieve a dramatic reduction in export subsidies on dairy products and to eliminate trade barriers. If our negotiators achieve this goal, then U.S. dairy farmers will have an opportunity to develop new markets for their products at profitable prices. This is the only way that dairy farmers in this country can afford to grant imports any greater market access to the United States.

As a dairy farmer, I oppose negotiating a free trade agreement with Australia or New Zealand for the simple reason that such an agreement would be a one-way street for dairy. Our industry joined the rest of the agriculture community in supporting the Bush Administration's quest for Trade Promotion Authority. It is very disappointing that the Administration is choosing to use that authority to pursue bilateral agreements that would hurt the dairy industry. Instead, the Administration should focus its efforts on negotiating a comprehensive, multilateral agreement in the WTO. In that forum, dairy farmers have a reasonable hope of gaining new markets.

That said, I support the passage of H.R. 1160, which would establish new tariffs on Milk Protein Concentrate imports. This bill would impose a new tariff rate quota on MPC imports and close the MPC loophole. Getting this legislation passed is one part of a three-pronged strategy to address MPC. The other two prongs include getting U.S. Customs to adopt a standard definition of MPC and establishing a protocol to stimulate a domestic MPC industry. Through this strategy, we hope to prevent MPC from further displacing domestic milk supplies.

I want to personally thank the 100+ Representatives who have agreed to sponsor H.R. 1160. Dairy farmers throughout the country appreciate your support. For those of you who haven't agreed to sponsor the bill, or who haven't decided to vote for the bill yet, I encourage you to extend your support for this important piece of legislation benefiting U.S. dairy farmers.

I also encourage the United States Department of Agriculture to respond more quickly when imports coming to our country exceed safeguard levels. Under the current trade rules, the United States provides substantial access to our markets for imported dairy products. Those same rules include safeguards to assure that imports do not have an excessive impact on the U.S. dairy industry. In recent years, USDA has not acted quickly enough to trigger those safeguards when imports exceed the maximum.

The same rules that require the U.S. to allow imports give us the right to cut off imports if they exceed the levels specified by the WTO. The Administration needs

to demonstrate its support for U.S. dairy farmers by exercising those safeguards promptly when the trigger levels are exceeded.

Again, I thank you for the opportunity to testify before your subcommittee today. From my testimony, you may think there's a lot of doom and gloom out there in the dairy industry right now. But, from my perspective, there's a lot of hope, too. Dairy farmers are eternal optimists. We love what we do, despite the hardships we face. I truly believe by working together as producers, within our cooperatives, with industry and non-industry organizations, and with legislators like you, we can build a stronger, more viable future for all U.S. dairy producers.

We do need your help and support, though. As I said earlier, programs like the Dairy Price Support Program and the Dairy Export Incentive Program are working to benefit producers, and we need you to give them your continued support. We also need you to continue to keep the farmer's best interest in mind when developing legislation that affects dairy trade obligations, environmental restrictions and income subsidies. Our goal as dairy farmers, and as an industry, is to create a marketplace where supply and demand work together to generate reasonable and realistic profits for producers, without substantial dependence on government subsidies. Anything you can do to help us build and sustain that marketplace is greatly appreciated. Thank you.

NATIONAL FAMILY FARM COALITION

The National Family Farm Coalition (NFFC) serves as a national link for grassroots organizations working on family farm issues, representing 32 grassroots organizations in 30 States. Through the NFFC, these organizations collaborate regionally on nationwide campaigns making the most of every group's experience, resources, and impact. Member organizations, comprised of farm families and concerned citizens, all suffer from the ongoing and deepening economic recession in rural areas caused primarily by historically low farm prices and the increasing corporate control of agriculture. NFFC unites these farm organizations in their common concerns and provides a forum in which to work for a change in farm policy.

To address the current dairy crisis across the Nation, NFFC created a dairy subcommittee, a sector of its Farm & Food Policy Task Force. Farmers from Vermont to California participate in the dairy subcommittee, formulating national strategies to: combat corporate campaigns for milk protein concentrates (MPCs), write effective dairy policy alternatives (found in NFFC's Food From Family Farms Act) and petition government agencies to uphold the law.

It is no secret that dairy farmers find themselves in devastating times. Bryan Wolfe, Vice President of the Ashtabula, Geauga & Lake County Farmers Union in Ohio, touched base with his local farmers. "Clearly they felt great frustration and despair about the future of their farms," Wolfe said. "They commented on totally inadequate milk prices, dismal crop progress (or total lack of progress) due to recent weather conditions, their inability to secure bank loans or support, and the extremely high costs of maintaining equipment—these farmers are desperate."

The average dairy farm lost $1.21 per hundredweight in 2001. U.S. Department of Agriculture (USDA) officials claimed a national dairy industry expansion led to 2002 price plummets. Rising land values in California, however, provided an opportunity for some dairy farmers to expand in western States, like Utah and New Mexico, where land costs prove significantly lower. Therefore, in 2002 production expanded in only five out of the 15 major dairy States, all concentrated in the western United States.

"The ever-expanding factory-style dairy farms in the West led to an oversupply of milk," said executive director of the Hartford Food System Mark Winne. "This left dairy farmers across New England receiving the lowest milk payments in 25 years—$1.04 per gallon—yet their production costs are more than $1.50 per gallon."

None of these issues came up during the House Agriculture Subcommittee on Department Operations, Oversight, Nutrition and Forestry hearing on May 20, 2003, however, held to discuss the state of the dairy industry. Various dairy industry representatives testified—all from the largest sectors such as the National Milk Producers Federation and the International Dairy Foods Association. Almost all testifiers uttered the phrase "current dairy policies and programs are not working," at one time or another during their statements—at no time, however, did they stop to explain why. U.S. dairy policy fails because it does not: include a cost of production formula, re-establish fair farm-gate price funding in the market place, and/or allow the market place to stabilize properly.

Milk cooperatives began with good intentions, authorizing farmer associations to form voluntary cooperatives for the producing, handling, and marketing of agricul-

tural products. This risk management tool, designed with farmers in mind, delivered prices at the cost of production plus a return on investment to producers. Current dairy policy, however, does not include a cost of production formula. Furthermore, dairy payments allotted in the 2002 farm bill, while helping a small amount with farmers' monthly cash flow, further depress farm prices at a time of increasing national budget deficits.

Therefore, the NFFC strongly supports a national dairy policy that would implement a cost of production formula using USDA Cost of Production figures plus any additional factors not adequately reflected in these data. This policy approach would also apply to feed grains and wheat. America's current cheap grain policy is fueling the expansion of corporate livestock and dairy operations because it is ″cheaper″ to buy the feed than to grow it. Farmers who produced feed for dairy cows lost $76.98 per acre in 2001, down from a loss of $128.17 in 2000 for corn production. For soybeans, the other important feed ingredient, crop farmers lost $85.68 per acre in 2001.

Today, the largest milk cooperatives in the U.S. abuse the power to collectively bargain on behalf of dairy farmer members in order to obtain just and equitable milk pricing. In fact, many milk cooperatives and dairy processors work collaboratively to keep farm milk prices low, reducing corporate costs. Thus, re-establishing fair farm-gate prices in the market place proves vital to effective dairy policy.

As it stands today, however, the U.S. government allows corporations to work both sides, buying domestic products significantly below the cost of production while generating additional profits from low-cost imports also supplemented by taxpayers money. For example, Dairy Farmers of America (DFA) is a dairy cooperative for U.S. dairy farmers. It controls 29 percent of the Nation's milk, holds 11 import licenses and maintains multiple partnerships with foreign and domestic institutes that hold a vested interest in keeping farm milk prices low.

The record shows that in the first week of May 2003, DFA sold 1,533,019 pounds of cheese to the USDA's Commodity Credit Corporation (CCC) surplus program. In the same week, DFA, in a joint venture with New Zealand giant Fonterra, sold 1,061,748 pounds of powdered milk to the CCC from Portales, New Mexico. Thus, in one week, DFA and its New Zealand partner garnered $2,583,856.10 from U.S. taxpayers, contributing to the illusion that America's dairy farmers produced more than the market demands.

The Subcommittee only heard one "family farmer voice" during its hearing. This farmer, a dairy producer from Bridgewater, Virginia, spoke for 5 minutes—he also happens to be a DFA Corporate Director.

John Bunting, a New York dairy farmer and NFFC dairy subcommittee member, compiled several graphs illustrating the dairy industry situation using USDA data. Bunting found that domestic milk production is actually in a deficit situation, not meeting U.S. consumer dairy demand. Moreover, USDA skews the data for domestic dairy consumption by not including imported dairy powders such as MPCs. Including these figures would demonstrate an additional shortfall of U.S. milk production by five to 10 percent.

In 2000, over 52,000 metric tons of MPC entered the U.S.—the equivalent of 4.6 billion pounds of domestic milk. MPC is shipped to the U.S. as a chemical or pharmaceutical product, circumventing dairy tariff and quota rate schedules, allowing corporations to skirt the limits imposed by current trade agreements. Since 2000, use of MPC imports in dairy products dramatically increased each year.

Increasing MPC use leaves more dry milk on the market, which CCC buys under its price support program. From 1996 to 2000, CCC support program costs increased by $572 million: an additional cost to taxpayers directly linked to displaced dry milk saturating dairy markets.

Dairy processors directly link MPCs use to higher profits and depressed farm milk prices. A current MPC patent application by Kraft Foods North America, Inc. states:

"It would be beneficial to provide a process cheese base prepared with edible powders as a substitute for some or all of the natural cheese normally used in the production of process cheese for several reasons. Unlike natural cheese, such powders have the advantage of an extended shelf life. Thus, unlike natural cheese, these powders can be purchased when supplies are high and prices are low, and then used over an extended period of time. Further, it is often cheaper to purchase such powders than natural cheese."

Thus, NFFC requests the 108th Congress work to prevent the illegal use of MPCs in standardized food products by forcing the Food and Drug Administration (FDA) to enforce Federal standards and take regulatory action against illegal, adulterated products. The FDA never approved MPC as a food ingredient because it does not meet "Generally Regarded as Safe" (GRAS) standards. By law, any food ingredient not in common use before 1958 must meet GRAS standards. In these vulnerable

times, food safety should be of utmost importance to U.S. lawmakers; currently, MPC freely enters the U.S. as a white-powder substance, often times not inspected at port entries, much less for human consumption.

Finally, current dairy policy does not allow the market place to stabilize. As exemplified, current dairy policy is costing America's taxpayers while enabling dairy exporters and purchasers of U.S. milk to buy from the farmer at the cheapest possible price. Moreover, the government does nothing to protect the consumer, who continues to pay the same or increasing prices at the grocery store for dairy products while the processors and retailers reap record profits.

For example, while New England dairy farmers suffer through the lowest milk prices in 25 years, the region's predominant dairy processor, Dean Foods (formerly Suiza) profit from an increasing wholesale-retail price spread. Currently, America's farmer receives only 28 percent of the product's retail price. Meanwhile, Dean's stock rises from just under $30.00 in September 2001 to $45.75 after profiting from low farm milk prices.

Based on recent research published by Ron Cotterill at the University of Connecticut, the retailers gross nearly $2.00 for every gallon of milk supermarkets sold, proving current dairy policy failed to address obvious market signals.

Perhaps the current dairy policy failed to respond to market signals because large dairy operations inherently fail to respond as well—if the market signals there is too much milk, large dairy operations respond to these low milk prices by producing more milk. If milk prices rise, large dairy operations tend to expand. Because large dairy operations depend on purchased stock for expansion, many also depend on cattle replacements to maintain its herd.

From 1998 to 2002, the U.S. imported 298,000 dairy cattle from Canada whereas in 1997, the U.S. imported only 19,000. Therefore, in 2002 the U.S. dairy herd increased not because of high milk prices but because mainly large dairy operations imported 62,000 cattle to "maintain" and "expand" production. Under a diversified, sustainable dairy operation, this type of expansion is unnecessary. Moreover, the large dairy operations depend on a minimum-wage labor force, many that work long hours and perform multiple milkings everyday. Increasingly, this labor force consists of Latino immigrants.

During the hearing dairy producer Chuck Ahlem, owner of a 1,700-cow operation, referred to contamination risks like mad cow disease (bovine spongiform encephalopathy or BSE) and emphasized tracking system needs, especially within larger operations deemed more efficient by USDA economist Keith Collins. Country of Origin Labeling (COOL) as described in 2002 farm bill guidelines would require these tracking systems, yet many companies claim the tracking system implementation is too costly. Ironically, as Ahlem emphasized its need during questioning, Secretary Veneman announced the latest Canadian BSE outbreak. For public health safety, consumers must maintain the right to know where his/her food originates and what happened to it along the ever-shortening value-added chain.

The question consumers should be asking themselves is: "What is the price of public safety and why do corporations feel the need to hide this information?"

In closing, consider this: in 1952, President Hoover reflected upon the policy path chosen during the Great Depression (1929). Hoover said: "Secretary of the Treasury Mellon, who felt that government must keep its hands off and let the slump liquidate itself had only one formula: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate." He insisted that, when the people get an inflation brainstorm, the only way to get it out of their blood is to let it collapse.

This testimony reflects the views and beliefs of NFFC's farmer members. If the present day "leave it alone liquidationists" dictating present dairy policy fails, then America's dairy infrastructure will collapse without a "plan B," leaving the Nation's dairy supply vulnerable and completely dependent upon foreign imports. There will be no sustainable dairy farms. There will be no viable rural communities. There will be no dairy farmers left. "Right now the hope of recovery is gone," said Bunting. "Because of low milk prices, most farmers don't have the money to plant spring crops and farms are collapsing faster than anyone could have anticipated."

NFFC urges the 108th Congress to establish sound dairy policy now—do not rely on the National Milk Producers Federation's (NMPF) "quick-fix Band-Aid approach" Cooperative's Working Together (CWT) Program. The CWT program, as proposed by NMPF, would charge every dairy farmer an assessment, or ″tax,″ used to finance a dairy-herd reduction, theoretically decreasing milk production. The fact of the matter is the CWT program will finance a "herd retirement program" in the western States, States that create America's dairy surplus, with taxes from farmers who can least afford it—those in the Northeast and Midwest. The CWT program is dangerous because desperate times call for desperate measures—if NMPF allows all farmers to participate, farmers in the most desperate economic situation will choose

to sell-out. "One farmer said that if the CWT whole-herd buy-out program is instituted, he will 'jump' on it," said Bryan Wolfe. "Because he's had enough."

Unlike NMPF's unsustainable approach to managing a very serious dairy crisis, the NFFC's policy approach would help stabilize supply with demand and create a dairy system that truly works for the Nation's dairy farmers, rural communities, and consumers. A serious, long-term national dairy policy must be considered by the 108th Congress today—NFFC challenges Congress to tackle a much needed "plan B" approach to America's failing dairy industry.

NMPF Answers to Submitted Questions

From Congressman Dooley:

1. Assuming the CWT achieves the goal of 80 percent participation, how much revenue will be collected under the program and how will it be used?

80 percent of 170 billion pounds of production, multiplied by the 17.9 cent assessment, will raise about $243 million. The money will be used by CWT to reduce milk production over the 12 months of the CWT program through three methods: a herd retirement program, a reduced production marketings program, and an export assistance program. Approximately 3 percent of the money will be used for administrative expenses.

2. According to your website, CWT will focus on milk reduction in those regions where the greatest increases in production capacity currently exist. How will the CWT regional allocations and controls work?

The final program will have parameters to ensure that no one region within the country suffers a disproportionate loss of production capacity due to the level of program participation. In certain regions of the country, program participation will be limited to one-half of 1 percent of annual milk output to ensure that areas with stable or declining production are not disadvantaged. In other regions where expanding milk production capacities render such safeguards unnecessary, the regional ceilings for milk reduction will be much more liberal. This feature will ensure that CWT will focus on reduction in those regions where the greatest increases in production capacity currently exist.

3. The CWT export price assistance program appears to present potential vulnerabilities for US dairy exports under WTO rules governing dumping and export subsidies. Please explain how the WTO rules may apply to the new CWT export program?

We disagree that the CWT program presents any problems for US dairy exports under either the WTO rules governing dumping or the WTO rules governing export subsidies. The WTO agreements are trade agreements among sovereign nations that discipline the actions of those countries, but do not regulate in any way the private activities of citizens of those countries. The CWT will be a purely private activity conducted by dairy producers without any government involvement or assistance, and therefore has no WTO implications.

First, with respect to dumping, the applicable WTO rules are contained in Articles VI of the General Agreement on Tariffs and Trade (GATT), and the WTO Understanding on the Implementation of Article VI of the General Agreement on Tariffs and Trade. Those rules impose certain requirements on Member countries with respect to the operation of their respective antidumping laws. In other words, WTO rules on dumping relate to the procedures and tests that a national government can apply when it seeks to impose additional antidumping duties on the goods of another country. These rules are entirely inapplicable to the actions of a private entity such as CWT.

Second, the WTO rules governing export subsidies on agricultural products are also inapplicable to CWT. The applicable rules are Articles 3.3, 8, and 9 of the WTO Agreement on Agriculture.

Article 8 states that "[each] Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in a Member's schedule." Article 3.3 similarly provides, in relevant part, that "a Member shall not provide export subsidies—in excess of the budgetary outlay and quantity commitment levels [in] its Schedule."

Under international law, a subsidy is a grant or benefit conferred by reason of governmental action. See e.g., WTO Agreement on Subsidies and Countervailing Measures, Article 1 (Definition of a Subsidy). Article 9 of the WTO Agreement on Agriculture lists the various types of agricultural export subsidies that are disciplined under WTO rules. All of those subsidies involve either direct payment by a government or some form of governmental action that results in a subsidy benefit.

The CWT program is not a government program. It will not require or involve any governmental action or involvement in its implementation. Dairy producers will act in association to privately fund the various activities of the program including the export assistance component. There will be no government funds involved nor any government mechanism for funding or carrying out the program.

The WTO Agreements are trade agreements among its Member countries and discipline the actions of those Members. The WTO Agreements do not regulate the private commercial activities of individual citizens or groups of citizens of those countries. WTO rules bind nations to certain obligations; they do not bind or apply to private individuals.

4. Please explain how CWT complies, or doesn't comply with U.S. antitrust law, including but not limited to the Capper-Volstead Act?

The CWT will operate in a manner fully consistent with the antitrust laws. For nearly a century, Congress has provided specific protections under the antitrust laws, first pursuant to section 6 of the Clayton Act and subsequently under the Capper-Volstead Act for certain classes of persons acting cooperatively or in association. Section 1 of the Capper-Volstead Act specifically establishes protections under the antitrust laws for farmers acting in association, and provides that "persons engaged in the production of agricultural products such as farmers, planters, ranchers, dairymen, nut or fruit growers may act together in association—in collectively, processing, preparing for market, handling and marketing in interstate and foreign commerce, such products of persons so engaged." The CWT program will be an activity of dairymen acting together in association contemplated by the statute. The CWT program will be established, constructed and implemented in strict accordance with the antitrust protections afforded by Capper-Volstead, as that law has been interpreted and construed by the courts.

FROM CONGRESSMAN STENHOLM:

1. Do you support provisions of the farm bill which permit the Department [USDA] to adjust the butter/nonfat dry milk purchase price relationship? What is the best way to determine the appropriate relationship?

The basic purpose of the dairy price support program is to provide a safety net for dairy farmers, to stabilize milk prices and dairy farm incomes. The program operates best when products are purchased and removed from commercial markets during times when milk and dairy product prices are low and when government stocks are sold back to the commercial market during periods when prices were high. Operating the program with the objective of minimizing government costs, or of reducing stocks, or to "better align support prices with market prices" is inconsistent with the basic purpose of the program, which is designed to affect market prices, specifically to maintain prices at minimum levels during periods when market forces would establish prices below those minimum levels.

Over time, Congress has made changes in the provisions of the dairy price support to ensure that the Department of Agriculture carried out the basic purpose of the program. Prior to the early 1980's, USDA had discretion to establish the price support level within a wide range, based on the parity concept. Since the early 1980's, the Congress has established the price support level. During the 1980's, when Congress provided that the price support level be established through a formula based on the milk equivalent of projected purchases, USDA exercised discretion in applying this formula by choosing the method of calculating milk equivalents that maximized the chances of triggering price support cuts. In the 1990 farm bill, Congress mandated the particular milk equivalent calculation to be used in applying this formula.

In the 1990 farm bill, Congress also reduced the department's discretion to adjust the butter-nonfat dry milk purchase price relationship by limiting such adjustments to no more than two per year. Throughout the 1990's, USDA's use of this limited discretion was not disruptive to the dairy industry because producer prices were established almost entirely by a cheese price-driven adjustor, the Basic Formula Price. However, beginning in 2000, Federal milk order reform introduced dairy product price formulas, under which butter and nonfat dry milk prices established prices that dairy farmers receive for about 60 percent of their milk. Overnight, USDA's discretion to adjust the butter-nonfat dry milk price relationship changed from a fine-tuning mechanism to full discretion to adjust the support price for 60 percent of the milk produced in the United States. Yet USDA continues to exercise this discretion as if it were a fine-tuning mechanism, with devastating consequences for dairy farmer income. The tragic irony is that, by tilting the butter-nonfat dry milk price relationship in an attempt to reduce CCC costs and reduce CCC purchases and

stocks of nonfat dry milk, USDA has actually increased CCC costs, due the existence of the MILC payment program, and has not reduced CCC purchases or stocks.

The best way to determine the appropriate relationship between the butter and nonfat dry milk purchase prices is to take fully into account the impact on dairy producer income resulting from any adjustments to this relationship.

2. Do you see signs that CCC stocks of surplus powder are serving as a depressing factor on market prices? If so, what types of steps would best alleviate that impact?

We are concerned that the current CCC stocks of surplus powder could limit future price increases, and we are encouraged by some of the efforts made by the Farm Service Agency to dispose of powder in a way that will not displace commercial sales on the market.

A number of the more effective programs that FSA has used to move powder out of inventory include shipment as overseas food aid; domestic distribution to the poor, where donations represent a new demand for milk; and animal feed programs that offer powder for direct use for foundation livestock which don't normally consume milk-based feed.

In addition, we have proposed to USDA a program to assist the domestic processing of dairy proteins, in order to meet the current domestic demand for high-end milk protein concentrates, casein, and caseinates. This could reduce CCC powder purchases by as much as 400 million pounds per year, which would contribute substantially to reducing the overhang. We look forward to continued progress on this proposal.

However, not all of the programs are effectively avoiding displacement of commercial product. As cited in our testimony, the initial design of this year's nonfat dry milk assistance to drought-stricken foundation livestock producers did not require that the powder be used directly by the targeted herds, as was required last year. Instead, they offered powder to the states, giving them great latitude to put government powder (effectively donated by CCC) into the market at as low a price as they wish, and allowing them to offer non-dairy feeds to the stricken livestock. FSA responded to industry concerns with changes to the contract provisions; but we have already heard accounts of some of this powder—designated for animal feed—being offered in the market at deep discounts and in violation of the USDA's agreements with the states. If such abuse is taking place, it demands audit and enforcement; we hope USDA takes this responsibility seriously.

Other USDA programs are providing powder to states, which are using it to displace commercial fluid milk purchases for their prison systems. The cheese for powder swap recently initiated for USDA's feeding programs is also dumping powder on commercial markets at what is effectively below the nonfat dry milk support price. This simply displaces producer milk, which is diverted to the dryers and sold to the CCC.

Under present circumstances, any program that attempts to reduce CCC powder inventories by moving powder into normal commercial channels must fail. This is because milk displaced by powder use will simply be turned into powder and sold to CCC. This rotation of CCC inventories can come at a higher cost per pound than that of destroying the original inventories.

There is clearly considerable scope today for the movement of powder through foreign aid. We encourage USDA to overcome all the economic and logistical difficulties in acquiring U.S. powder that is suitable for these programs. In particular, CCC must recognize the full costs of providing the additional processing of these products in large volumes over a short period, and be willing to pay these costs.

3. Considering the MILC program's taxpayer cost, market impact, and direct impact on producers, how do you rate or evaluate this program in terms of its bang for the taxpayer buck?

The dairy price support program is the most efficient means of providing a safety net to dairy farmers. By purchasing a small fraction of domestic dairy product production when market prices are weak, the program provides a price floor for all milk marketed by dairy farmers. It is essential that the program provisions be properly implemented by USDA to ensure that producers receive at least the support price for their milk used for manufactured products. However, the program leverages taxpayer expenditures very effectively to provide downside price and producer income protection. The return to taxpayer investment in terms of producer income is many hundred percent.

Direct payments, such as the MILC program payments, cannot provide the same degree of leverage. A dollar spent can provide no more than one dollar of producer income. Furthermore, when the program has a negative impact on producer prices, as Dr. Brown has calculated, and as many in the industry believe, then the return

to taxpayer investment in terms of producer income is less than one to one, i.e., less than 100 percent.

4. Both the price support program and the MILC program have countercyclical impact. Can you compare the two: how are they alike and how are they different from the perspectives of taxpayers, consumers and producers?

The price support and the MILC programs both have minimal effects on consumers, but they differ greatly in terms of their impact on producers. The price support program is scale neutral: all producers benefit equally regardless of size. The MILC program, by contrast, discriminates based on size. Smaller producers, whose payments are unaffected, or minimally reduced, by the payment cap, receive total returns (market price plus the MILC payment on a per hundredweight of milk basis) that are greater than they would receive in the absence of such a program, as Dr. Cropp has indicated. Larger producers, on the other hand, whose payments, averaged over their entire production, are less than the market price reduction due to the payments, actually lose money under the program. The MILC payment program is therefore divisive among producers, and has aggravated regional divisions that the National Milk Producers Federation has had considerable success in overcoming in recent years.

5. Concerning a chart on milk prices, isn't this particularly unusual volatility in dairy prices? How can any component of the dairy industry make sound investments when basic product prices are so erratic? Are there particular underlying factors that are making dairy prices move so dramatically?

Yes, prices have become more volatile since the support price was lowered from a level that regularly set the domestic market price to a true safety net program that only set the market price in exceptional circumstances. Today prices are low in part because USDA has aggressively tilted the nonfat dry milk price downward. With the current inventories, no milk price boost can fully stand up to reductions of the support price for nonfat dry milk.

Several structural issues are also contributing to the low lows, without necessarily boosting the highs:

It is an unfortunate fact that in recent years, when prices have been low, the reduction in milk production has come primarily from the exit of small farms. In all parts of the country, dairy farms are getting larger and fewer. Just 10 years ago, herds under 100 produced nearly 45 percent of U.S. milk; so there was a lot of room for reduction through exit. Today, farms with less than 100 cows produce less than a quarter of U.S. milk. This means that there is less room for a supply response from small producers.

Slowing demand growth is also causing problems. Rapid cheese consumption over the last 30 years has meant that the industry could rapidly grow out of low prices, whenever production outpaced demand. Today demand growth, though still positive, is slowing, so that a greater production response is necessary to return the market to balance. In recent years, the markets could balance without reducing cow numbers; today this is no longer the case.

Of course, growing imports of products, coming through our trade loopholes, have also been contributing to low prices, by displacing substantial volumes of U.S. milk.

Finally, the MILC program has been initiated at a time when all of the above are working against dairy farmers and the USDA is aggressively lowering milk prices. The MILC program is achieving its intended aim: it is keeping many small producers in business during the worst milk prices in a quarter-century, but by doing so, it is retarding what has become the normal means of returning the market to balance.

6. Do you discern differences between the Federal order and various State orders that serve to disrupt the orderly marketing purpose of the government policies?

We believe that the state and Federal orders work as complements to one another. There are distinct benefits in each; those who see them as in opposition to one another fail to recognize that each has evolved for its own reasons. We strongly encourage both USDA and the states to pursue constructive, complementary policies that allow them both to work in cooperation, not in opposition.

7. If the simple answer about why prices are low is that too much milk is being produced, why aren't producers responding? Why does milk production continue to increase?

Milk production continues to increase, despite low milk prices, for several reasons. First, favorable prices in 1998, 1999 and 2002 stimulated significant expansion, which was generally absorbed by the growing commercial dairy market prior to 9/11. The subsequent economic recession, compounded by the slowdown in the travel

and restaurant business, reduced the growth of dairy consumption, from over two percent per year to between zero and one percent during the last two years. This slowdown in demand growth will require a greater than usual reduction in milk production, and, hence, a longer period of low prices will persist before supply-demand balance can be restored and prices return to more normal levels.

In addition, producers are reacting more slowly to the current period of low prices. Compared with previous years and previous price downturns, more milk is being produced on large dairy farms, which bankers are more hesitant to liquidate. Guided by the length of previous price downturns, many lenders have been reluctant to foreclose on non-performing loans to large dairy operations, because the cost of doing so outweighs the cost of carrying the loans for the length of a normal price downturn. In addition, the MILC payments are shielding small producers from the full impact of current low prices. Small producers have traditionally borne the largest share of the adjustment to previous period of low prices, by exiting the business in relatively large numbers. With the MILC payments slowing this traditional adjustment mechanism, the adjustment to current low prices has been borne by mid-sized producers.

8. On February 11 of this year, USDA announced producer approval of new Class III and Class IV pricing formulas which were to take effect on April 1. This change was initially part of the 1996 farm bill directive, and of legislation enacted by Congress in December 2000. Now that this process is complete, please provide for the committee your views—on the process itself, and on the formulas that resulted?

The formulas themselves appear to be reasonable, and we look forward to their long-run implementation to verify that. They will inevitably need correction over time, if for no other reason than that the costs and efficiencies upon which they are based will change over time.

The process is the problem. As noted in the question, it took over 2 years and four months to move these formula changes from legislation to implementation. This is symptomatic of a growing paralysis in the Department of Agriculture and the Federal Government generally.

Over-centralization in executive branch departments may be aimed at increased accountability; instead, it creates bottlenecks in the offices of the Secretary and the Under Secretaries, who are unfamiliar with the details of the decision. This leads to long backlogs and repeated revisions of the same rule with little or no improvement. Such review should be re-engineered or reduced; in any case, it must be accelerated. (There are similar problems with interagency reviews.)

Certain types of impact analysis can be very important for putting regulation into proper perspective. However, the required laundry list of analyses has added tremendously to the paperwork involved in rulemaking and often slows implementation unnecessarily.

9. Concerning H.R. 1659 (Nunes bill), what is your view?

NMPF supports the Nunes bill, H.R. 1659. This legislation would correct a situation in which a handler will exploit minimum pricing provisions in both Federal and State market orders. By locating outside the state in which the plant intends to sell the bulk of his sales, and that state having no authority to regulate the milk, and by virtue the sales will not be into a Federal market order, in effect neither regulatory authority will be able to ensure a minimum price for milk is met by the handler. H.R. 1659 corrects that inequity loophole.

10. Concerning forward contracting, what points of [the recent USDA report] do you regard as significant?

A. USDA's Dairy Programs released its "Study of the Dairy Forward Pricing Pilot Program and Its Effect on Prices Paid Producers for Milk" in January. Here are some of USDA's highlights, with NMPF conclusions:

Price Comparisons. The simple average price for contracted milk during the study period (September 2000 through March 2002) was $14.02 per hundredweight; the same milk would have been paid $14.51 without contracting. This means that the simple average loss, across months, was 49 cents per hundredweight. Calculating from the data in the study's appendix, the weighted average loss over the study period was even higher: $1.23. This would seem to be damning; how can a program that loses producers $1.23 per hundredweight be defended?

An alternative approach was to compare contract prices with the future prices when contracts were signed. USDA did this for each quarter, but did not publish a weighted average for the entire study period and refused to provide it upon request. However, contract volume was greatest in the same months for which the contract price was substantially below the futures price. By this measure, it seems that the weighted average impact of contracting was negative for producers, compared to using futures markets. This raises a real concern about allowing handlers

an opportunity to press producers into a contract price that is below the market's current expectations, without even a long-term responsibility to pay Federal order minimum prices.

Pressure to Contract. USDA reported that 7 percent of contracting producers felt obliged to sign a forward contract or lose their outlet for milk. This percentage may seem small, but it is large enough to be disturbing. We anticipate that when the volume of milk under contract reaches a critical point, producers will be driven to accept disadvantageous contract prices under threat of losing their milk outlet.

*Implications.*The forward pricing pilot program has great potential to undermine the farmer's minimum price guarantee under the Federal or state order systems. This report seems to support that:

(1) Contracting producers suffered a clear revenue loss compared to non-contracting producers during the study period;

(2) There appears to be a bias towards lower producer prices for contracting producers, even in the long run; and

(3) A small but significant percentage of contract producers felt that they would lose their milk outlet if they did not enter into a contract that stripped them of their Federal order price protection, and did not even offer them enforcement of the contract price, except through the courts.

The report does nothing to lay to rest our suspicions about the ultimate effects of the program.

Other Programs Already Available. Currently, there are approximately 8 billion pounds of milk priced in the Futures and Options markets, which is already available as a risk management tool.

Cooperatives as Producers. Regarding the argument that proprietary handlers simply want the same opportunity to reblend and forward price that cooperatives already have, it should be noted that cooperatives are, in fact, producers and have always been assumed to act in the direct interest of their producer-owners. This is a completely different relationship from that of independent producers shipping to a proprietary handler.

Conclusion: Minimum Price Integrity. Federal market orders and State orders provide for minimum pricing provisions to ensure that suppliers selling milk to handlers are paid at least a minimum price. The forward contract pricing program allowed by the current pilot project and covered by the USDA study does NOT ensure a minimum price will be enforced. This pilot program should be allowed to expire.

USDA ANSWERS TO SUBMITTED QUESTIONS

QUESTIONS SUBMITTED BY REPRESENTATIVE STENHOLM

PRICE SUPPORT PROGRAM

The farm bill authorizes the Secretary to alter purchase prices for dairy products under the price support program not more than twice a year. What is the history of the use of this authority in the last several years? What criteria does the Department use to make the decision? Does the administration's process for making that decision include the involvement of the public or of industry experts outside the Department?

Four minor adjustments (3 cents or less) were made in purchase prices of cheese, butter, and nonfat dry milk (NDM) during the mid and late 1990's as the milk price support level was changed from $10.10 per hundredweight (cwt) up to a peak of $10.35 per cwt then down to the present $9.90 per cwt. Two minor adjustments in purchase prices were made in 2000 and 2001 to make the purchase prices consistent with Federal Milk Marketing Order (FMMO) reform.

Larger adjustments were made once in 2001 and once in 2002, lowering NDM purchase prices about 10 cents per pound each time and increasing butter purchase prices about 20 cents each time. USDA followed the historical practice of reducing the support purchase price for the portion of milk—fat or nonfat solids-that is accumulating in CCC inventory.

Factors considered in making the larger adjustments in purchase prices include: the impacts on government dairy product purchases, government inventory levels of dairy products, effects on milk producer income, and effects on milk and dairy product markets and market participants. Although public comments and industry experts' opinions are received throughout the year and used in determining the advisability of purchase price changes, CCC does not have a formal process to collect industry comment on each change in purchase price levels.

CCC PURCHASE PRICE ADJUSTMENT TO REFLECT ADDITIONAL COSTS

Actual class III prices in the last year have fallen below the support price of $9.90 established by the farm bill. What factors can you identify that explain this occurrence? In February, the National Milk Producers Federation (NMPF) petitioned USDA to adjust Commodity Credit Corporation (CCC) purchase prices to account for additional costs processors incur when they sell to CCC. What action has the Department taken with respect to this request?

The Farm Security and Rural Investment Act of 2002 (2002 Act) states that the Milk Price Support Program (MPSP) purchase prices shall be sufficient to enable plants of average efficiency to pay producers, on average, a price not less than $9.90 per hundredweight (cwt) for milk containing 3.67 percent butterfat. The class III price calculated by the Agricultural Marketing Service (AMS) is a minimum price for milk containing 3.5 percent butterfat. Actual prices producers receive are typically greater than the minimum, and prices for 3.67 percent milk are about $0.20 per cwt higher when butter is near its support price of $1.05.

CCC has historically interpreted-on average—to mean prices averaged over all cheese and butter/nonfat dry milk (NDM) plants (class III and class IV milk) on an annual basis. Weighted average prices, based on utilization, of milk used for cheese making (class III) and milk used for butter/NDM making (class IV) have exceeded $10 per cwt for the past three years. Annual average manufacturing milk prices reported by the National Agricultural Statistics Service (NASS) and the manufactured milk value calculated for USDA's Dairy Interagency Commodity Estimates Committee have also exceeded $10 per cwt.

While USDA is meeting its historical interpretation of the legislative mandate, supporting milk prices at $9.90 per cwt on average, it has been found that class III milk is not being supported equally with class IV milk. Reluctance of manufacturers to market cheese to CCC at the CCC purchase price has resulted in class III prices below $9.90 per cwt. Fixed make allowances under FMMO reform ensures processor profitability making them less responsive to high or low prices for cheese, since cheese price changes cause proportional changes in class III milk prices, which is their major input. USDA surveys have also found higher costs incurred to sell cheese to CCC versus the commercial market. USDA is reviewing these factors to determine if any actions can or should be taken.

NDM SURPLUS

USDA has adopted several policy tactics that are designed in part to dispose of CCC NDM stocks. What has been the affect of these actions?

NDM sales for animal feed, casein production, and unrestricted use and donations for domestic and foreign food aid have used much larger quantities of CCC stocks in fiscal year 2003 than in past years. About 170 million pounds of CCC NDM was used in fiscal year 2002 while 470 million pounds were added to inventory. Current NDM inventory, over 1.2 billion pounds, is similar to the fiscal year beginning level, 1.3 billion pounds, while purchases have exceeded 450 million pounds through May.

The National Milk Producers Federation (NMPF) recently noted that under the Department's 2003 Livestock Feed Assistance NDM Program, in some States feed processors are being permitted to sell the powder into the open market. What information can you provide about this matter?

Contract provisions were revised before any NDM was delivered to States to prevent marketing of powder into the open market. USDA is investigating a reported attempt by ranchers to sell NDM made available to food manufacturers. If abuse is found to be widespread, the sales of NDM by CCC for restricted use may be terminated.

Separately, a concern has been raised as well that nonfat dry milk donated to the state of Texas is being transformed for use as beverage milk in the prison system. What information can you provide the Committee in this matter? Does it appear that NDM donations are displacing or will displace commercial sales of bottled milk to the prison system?

This case has been investigated and prison officials have been informed that conversion of NDM to fluid milk is not an approved use of donated NDM.

MILK INCOME LOSS CONTRACT (MILC) PROGRAM

When the farm bill Conference Report was passed, CBO estimated that the Milk Income Loss Contract program would cost $963 million over its

lifespan of about 3 years. Under the CBO baseline released in March, the program is now expected to cost nearly $3.3 billion.

What is the administration's estimate of how much this program will cost?

The administration estimate is $3.5 to $4.5 billion for the full program for fiscal year 2003 through fiscal year 2005, with a few payments being made in fiscal year 2006 for fiscal year 2005 production.

Has the administration established under the program a final date by which eligible producers must sign up? If not, why not?

The final date by which eligible producers must sign up is September 30, 2005.

To the extent that the Department continues to allow producers to sign up for the MILC program, what is the current pace of sign-up compared to earlier periods? How many operations have signed up for the program? What is the Department's best estimate as to how many operations will participate that have not yet signed up?

We believe that most dairy operations have signed up for the program; however, exact estimates are being assessed pending modifications to the current software that will provide that information.

Some producers have filed a lawsuit contesting USDA's interpretation of the volume limit on MILC program payments. What technical issues are raised in this lawsuit, what was the Federal Government's response, and what is the current status of the suit?

The United States District Court for the Northern District of Ohio, Eastern Division, issued a decision in *Fullenkamp, et al.,* v. *Veneman* on May 19, 2003, granting the Government's dispositive summary judgment motion in full and denying plaintiffs' motion for injunctive relief. Plaintiffs were large dairy producers challenging the Department of Agriculture's implementation of the Milk Income Loss Compensation Assistance (MILC) Program. Specifically they challenged whether the production cap of 2,400,000 pounds in section 1502(d)(2) of the Farm Security and Rural Investment Act of 2002, which authorized the MILC Program, should be applied to transition payments, that is for payments made from December 1, 2001 through the month preceding the month the dairy producers entered into the MILC Program contract. The Judge found the statutory language was ambiguous on the question whether the production cap of 2,400,000 pounds should be applied to transition payments, and then found the Department of Agriculture's application of the cap in its regulation to be a permissible statutory construction that deserved judicial deference. She dismissed the plaintiffs' secondary challenges with respect to the timing of the transition and contract payments for lack of standing. Plaintiffs have file a notice of appeal.

Dr. Brown's testimony today estimates that the MILC program has depressed the producer's price by about 25 cents per hundredweight. Dr. Cropp testifies that the program has been a great help to smaller dairy operations. Considering the program's taxpayer cost, market impact, and direct impact on producers, how do you rate or evaluate this program in terms of its bang for the taxpayer buck? Both the price support program and the MILC program have counter-cyclical impact. Can you compare the two: How are they alike and how are they different from the perspectives of taxpayers, consumers, and producers?

MPSP and MILC are alike in that they are taxpayer-funded programs that support dairy farm income. The MPSP supports farm income by purchasing selected dairy products offered at prices that will yield $9.90 per cwt, on average. MPSP farm income support is indirect because purchases are made from dairy product manufacturers, while MILC payments go directly to farmers and are a percent of the difference between actual prices and $16.94 per cwt. Small changes in supply of dairy products lead to larger changes in their price, which means that MPSP's cost to taxpayers is usually lower than the MILC cost for the same farm income benefit. But MPSP leads to higher processor and consumer prices for dairy products. Producers usually prefer to get indirect support rather than direct support. Processors are better off with direct farm income support. Results for consumers are uncertain depending on whether higher product costs offset higher expenditures for direct payments.

MILK PRICES

The all-milk price for March 2003 was reported to be $11 per cwt. That's the lowest level in many years. One and a half years ago the all-milk price was $17.10. One year before that, it was $11.80 and a year and half before

that it was $18, and 9 months before that it was $12.10. These dramatic price swings take you back in time only to July 1997.

Isn't this particularly unusual volatility in dairy prices? How can any component of the dairy industry make sound investments when basic product prices are so erratic? Are there particular underlying factors that are making dairy prices move dramatically?

If the simple answer about why prices are low is that too much milk is being produced, why aren't producers responding? Why does milk production continue to increase?

Milk prices have always been cyclical. After a market disturbance, prices adjust more quickly and in greater proportion than does production. That in turn leads to adjustment, and sometimes over-adjustment, in production, and price changes in the opposite direction. Price volatility has been more pronounced since the mid–1990's. Record high corn prices in 1996 led to cutbacks in production that brought on high milk prices. High returns brought rapid expansion of western milk production, which drove prices down. Producer exits brought production down and brought higher prices. Moratoriums and permit delays slowed California expansion in 2000 and 2001, while rapid expansion took place in 2002. Structural change is a contributing factor as firms of different sizes react differently to market signals. Reduction in the milk price support level may have contributed to larger price swings, making dairy more like other commodities compared with the price stability it enjoyed when support prices were higher. The argument is that the lower price support level allows milk prices to fluctuate over a wider range and that leads to undue production adjustment. Of course, the price stability came at the cost of large government surpluses and high support program costs.

Milk cow slaughter has been about 15 percent above a year ago through the first five months of 2003 and milk production has recently started to be below year earlier levels. Milk production reductions and milk price recovery is expected in the second half of the year. MILC payments may have delayed market adjustment by allowing smaller producers to stay solvent with lower milk prices, but production is responding to the unusually low prices of the past year.

MILK PRICING SYSTEM AND FORMULAS—ORDER REFORM

It has been some time now since USDA and the dairy industry completed reform and consolidation of Federal milk marketing orders. What is your assessment of the success of the changes that were made? Do you discern differences between the Federal order and various State orders that serve to disrupt the orderly marketing purpose of the government policies?

The Federal Agricultural Improvement and Reform Act of 1996 required USDA to consolidate the existing Federal milk marketing orders (33 at the time) into not less than 10 nor more than 14 orders. On January 1, 2000, the 11 consolidated orders became effective. During the process all the provisions of the orders were reviewed with an eye toward simplifying and streamlining the resulting consolidated orders. The consolidated orders contained provisions that replaced the order-by-order class I price structure with a single surface for the contiguous 48 states, substituted a multiple component pricing system for the basic formula price, established a new class IV price for milk used to make butter and dry milk products, and made other minor changes. A notice and comment rulemaking procedure was utilized to make the changes and the reformed orders required producer approval prior to implementation.

Even though the consolidation process reviewed all aspects of the regulatory program at that time, marketing conditions within the industry are continually changing. Thus, some regulatory amendments made during reform, later yielded unintended and adverse consequences. As a result, a series of hearings are in process, or were recently completed, regarding pooling provisions of the consolidated orders.

There are differences between the Federal milk marketing order program and State orders. In general, they work well together, and there is little disorder caused by the differences. However, the commerce clause of the United States Constitution does present challenges for State orders regarding the regulation of milk that comes into or leaves a State. As a result, Federal orders have replaced State regulations when the market disorder caused by incoming or outgoing milk becomes too significant.

NEW CLASS III AND CLASS IV FORMULAS

On February 11 of this year, USDA announced producer approval of new class III and class IV pricing formulas, which were to take effect on April

1. This change was initially a part of the 1996 farm bill directive, and of legislation enacted by Congress in December 2000. Now that this process is complete, please provide for the Committee your views—on the process itself, and on the formulas that resulted.

As a result of the Consolidated Appropriations Act, 2000, legislation mandating a review of the class III and class IV pricing formulas, USDA held a formal rulemaking hearing during May 2000. Based on the hearing record, a tentative final decision proposing regulatory amendments was issued and approved by producers. The new class III and class IV pricing formulas became effective on January 1, 2001. A court order was issued on January 30, 2001, that enjoined implementation of part of the amendments as approved. Further amendatory changes were made during 2002 and approved by producers. On April 1, 2003, the new class III and class IV pricing formulas became effective.

The class III and class IV price formulas provide the basis for pricing all milk priced in the Federal order program. Prior to adoption of the product price formulas for class III and class IV milk, competitive pay prices were used. Originally the Minnesota-Wisconsin manufacturing price series and then the Basic Formula Price were used to price milk used in surplus products. These two price series relied on what plants in the Upper Midwest were paying for milk in an unregulated and competitive market. As increasingly less milk was marketed in this area order, a replacement pricing mechanism became necessary. Changing the method for pricing surplus milk from a competitive pay price to a product formula, that converts wholesale prices for butter, cheese, nonfat dry milk, and dry whey back to the raw milk used to make the products, was a complex undertaking for USDA and the dairy industry.

USDA recognizes that the values used in the product price formulas will always be subject to criticism. Thus, to ensure that the formulas are adequately representing industry values, the formulas will need to be reviewed from time-to-time using the formal rulemaking process.

H.R. 1659 (NUNES BILL)

Pending in the Agriculture Committee at this time is a bill—H.R. 1659—which is designed to ensure that a fluid milk bottler situated in Arizona is not able to avoid milk price regulation by selling across the State border into California.

Is the Department aware of the situation that has led to the introduction of this bill? Has the Department either considered or been asked to consider taking regulatory action with regard to the situation?

The Department is aware that a plant located in the Arizona-Las Vegas marketing area has started processing and shipping fluid milk products into California. However, Federal milk marketing orders regulate fluid milk handlers based upon where they compete for sales, not on physical location. Under the current regulatory rules, if the handler (plant) has no sales in any Federal order marketing area, the plant will not be regulated by a Federal order.

Clark County, Nevada exemption

Question:
Under a provision of law enacted in the Agriculture Appropriations bill for fiscal year 2000, handlers located in Clark County, Nevada, are not subject to the requirements of Federal milk marketing orders.

What information can you provide about the impact of this Congressionally mandated provision?

Answer:
The fluid milk processor located in Clark County, Nevada, while no longer being subject to Federal order regulation, is regulated by the Nevada State milk commission. Prior to the above referenced legislation, the Federal order Class I differential was $1.60 per 100 pounds for the Las Vegas area. The Federal milk marketing order consolidation required by the 1996 Farm Bill resulted in a $2.00 Class I differential for the Las Vegas area. Under the Nevada State regulations the Class I differential is currently $1.50. Thus, a handler in Clark County, Nevada, has a location advantage in serving local accounts (competitors in California, Arizona, and Utah have costs associated with transporting packaged fluid milk into Clark County) and a raw milk cost advantage as well ($1.50 Nevada Class I differential versus a $2.00 Federal order Class I differential in adjacent counties.)

While the current handler in Clark County has not yet caused any significant market disorder, that may not be the case for a new handler in the future. The Department is aware that a new fluid milk plant is being built in North Las Vegas. Public announcements by the plant owner indicate that the plant will service accounts in five southwestern states and this could result in market disorder.

Forward Contracting

Question:
USDA's Agricultural Marketing Service recently provided its report to Congress regarding the Dairy Forward Contracting pilot program. What points of that report do you regard as significant?

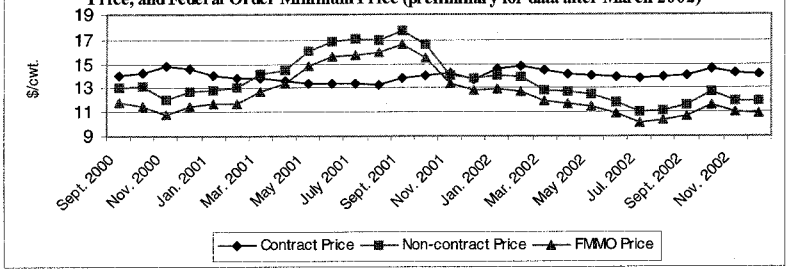
Answer:
As measured in terms of reduction in price volatility, the Dairy Forward Pricing Pilot Program (PFPPP) has been effective. Average monthly prices received for contract milk during the study period from September 2000 through March 2002 ranged from $13.23 to $14.86 per cwt. The average monthly prices for the same milk, had it not been under contract, ranged from $12.04 to $17.75 per cwt. Preliminary data from April through December 2002 indicate contracts continued reduction of price volatility. The range of prices received for contract milk remained about the same as it was during the study period, but average non-contract prices received reached a low point of $11.01 per cwt. in July 2002. See Figure 1.

Forward contract milk pricing shows patterns similar to those of the Chicago Mercantile Exchange Class III futures market.

Participation in the DFPPP was only 3.9 percent of eligible producers and 5.7 percent of proprietary manufacturing plants. Participation declined toward the end of the study period-especially by small producers. See Table 1 and Figure 2.

Forward contract activity has been concentrated mainly among cheese plants in the north central area of the country.

Figure 1: Average Prices At Test: DFPPP 1/ Contract Price, Non-Contract Price, and Federal Order Minimum Price (preliminary for data after March 2002)

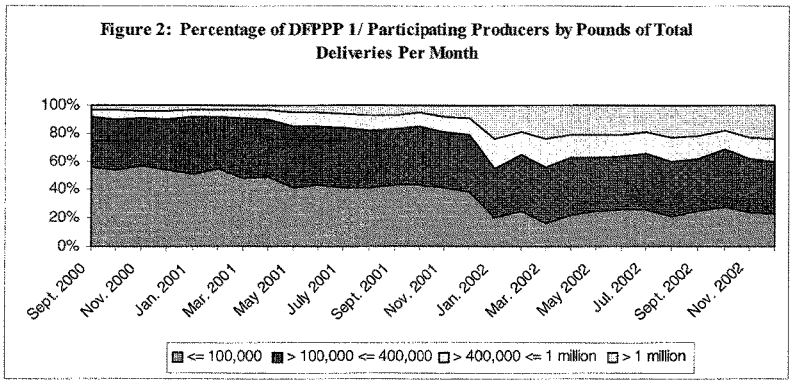


1/ DFPPP is the Dairy Forward Pricing Pilot Program.

Table 1: Number of Producers Delivering Milk Under the DFPPP by Month (preliminary for data after Mar. 2002)

	Year		
Month	2000	2001	2002
Jan.		994	169
Feb.		1005	137
Mar.		1032	171
Apr.		1141	197
May		780	194
June		819	201
July		865	215
Aug.		873	200
Sept.	304	873	205
Oct.	317	822	173
Nov.	324	743	192
Dec.	319	721	188
Average	316	889	187

1/ DFPPP is the Dairy Forward Pricing Pilot Program.



1/ DFPPP is the Dairy Forward Pricing Pilot Program.

Question:
Aside from the pilot program, many dairy farmers have the option of forward contracting their milk through agreements with their cooperatives. What evidence do we have about the use of these cooperative-run programs?

Answer:
An informal survey by USDA's Federal Milk Market Administrators indicates that, on average, between one-quarter and one-third of the cooperatives operating in the 11 Federal milk marketing orders are offering forward contracts, ranging from none in two markets to about two-thirds in another. It was estimated that about 2,400 cooperative-member dairy farmers, or about 5 percent, forward contracted a portion of their milk marketings some time during the previous year. About 65 percent of the cooperative members who forward contracted during the past year delivered milk to the Mideast, Central and Upper Midwest Federal milk order markets.

Question:
The Department has also attempted to foster dairy farm risk management with its Dairy Options Pilot Program. How do these two programs compare? What evidence does participation in these two programs provide about dairy farmer interest in the use of risk management tools?

Answer:
Participation in the Dairy Forward Pricing Pilot Program (DFPPP) has been low: 1,452 producers during the study period. As measured in terms of numbers of put options purchased, participation in the Dairy Options Pilot Program (DOPP) was low: 1,352 producers. However, 6,359 producers participated in DOPP training sessions. With the DFPPP in particular, dairy producers voluntarily gave up the minimum price protection provided by the Federal milk order program in order to receive relatively stable forward contract prices.

Possible reasons for low participation in the Dairy Forward Pricing Pilot Program:

- A handler can only forward contract milk to be used for nonfluid purposes: milk classified as Class II, III, and IV. Questionnaire results from the DFPPP study indicate that 44% of eligible producers did not participate, because their handlers did not offer contracts.

- Possible loss of upside price potential is a factor that could diminish interest for the DFPPP, whereas this would not be a factor for the DOPP.

- Market prices in 2001 were substantially higher than contract prices. In response to a survey question, the majority of participating respondents (58%) stated that they would probably not forward contract again or would reduce the amount of milk production they would forward contract. However, data collected during and since the study period indicate that a strategy of consistent forward contracting is likely to provide more stable prices, which average about the same as market prices.

USDA's Economic Research Service (ERS) is scheduled to provide a study to USDA's Risk Management Agency concerning the DOPP in September 2003. The DOPP included put options for Class III and IV futures. Possible reasons for low participation:

- Class III milk futures put options may provide only limited protection against price risk in markets where Class III utilization is low.

- The Class IV futures put options market may be perceived as too thinly traded to provide sufficient liquidity to minimize risks.

- Some producers may have felt that conditions for the DOPP were restrictive.

- The main intent of the program was to provide an educational benefit rather than a substantial commercial benefit. The volume of milk that could be hedged under DOPP was 600,000 pounds per year, roughly the annual production of 35 cows. Larger producers mainly looking for commercial benefit may not have found the program attractive.

- The depth and breadth of dairy extension education programs differ widely from

state to state, and while it is difficult to measure, this probably had some influence on differences in rates of DOPP participation across states.

International Trade

DEIP

Question:
Please update the Committee with regard to activities under the Dairy Export Incentive Program? What are your views about the status of the DEIP program and its effectiveness in promoting exports? Congress has specifically directed that the DEIP program be used as a tool for market development. What progress has been made in the use of the DEIP program in this manner?

Answer:
In the last programming year (2002/03, July/June), USDA awarded DEIP bonuses for the export of nonfat dry milk (NDM) and cheese consistent with the obligations of the United States under the World Trade Organization (WTO). This amounted to 68,201 tons of NDM and 3,030 tons of cheese. For butterfat, USDA awarded bonuses for the export of 10,000 tons out of the 21,097 tons allowed under the WTO. Given the price volatility of the U.S. butterfat market in recent years we have adopted a cautious approach with respect to the use of DEIP for butterfat in order to minimize any negative impact on the domestic butter market. The value of DEIP bonuses awarded this year totaled $39.7 million, with Mexico as the leading destination for DEIP products.

In terms of market development, the DEIP remains a valuable tool. In recent years, we have simplified the program to give dairy exporters greater latitude in terms of selecting destinations and pricing flexibility. As a result, Mexico has become a leading destination for U.S. dairy products, accounting for $201 million out of a total $919 million worth of U.S. dairy products exported in 2002. Undoubtedly, the implementation of NAFTA has been a key component in facilitating trade between the two nations. It is also widely recognized that in instances when global prices for NDM exceed the U.S. support price for NDM, unsubsidized sales of NDM flow principally to Mexico.

Another notable feature of the DEIP has been its success in raising the awareness of U.S. dairy producers to the potential opportunities for exporting their products. In sharp contrast to the early days of the DEIP, when exports were dominated by trading firms, the DEIP has been highly effective in encouraging the active participation of U.S. dairy cooperatives. This is best exemplified by the marketing cooperative Dairy America that is owned by a number of major U.S. dairy farmer cooperatives. Dairy America is not only the largest producer of NDM in the United States but it has evolved to become the preeminent exporter under the DEIP. From a market development perspective the DEIP has been a success in bringing U.S. dairy producers closer to their dairy markets.

Cheese imports

Question:
Last November, USDA announced that it was applying the volume-based World Trade Organization (WTO) safeguard duty to above-quota imports of American-type cheese. This action was taken because imports surged and rose above the safeguard trigger level. What has the effect been of this action by USDA? Was the duty increase imposed sufficient to stem over-quota imports? What impact was this action thought to have on domestic cheese and milk prices? Have our trading partners raised objections to the use of this safeguard?

Answer:
In response to the USDA decision to activate quantitative safeguards on American-type cheese imports, the U.S. Customs Service notified its field offices to collect the 35.2 cents/kilogram (16 cents/lb) duty for the period November 21 through December 31, 2002. (Thus the higher duties were in effect approximately 6 weeks.) In addition, out-of-quota (high tier) imports are also subject to a duty of $1.055/kg ($0.48/lb). Thus, after the change, out-of-quota cheese imports were subject to a duty of $1.407/kg or $0.64/lb.

As the following small table shows, it appears the safeguard duty was very effective in that imports dropped to near zero in the month where it was fully applied. However, it should be noted, monthly imports were dropping rapidly even before the change became effective.

Monthly Imports of out-of-quota American type cheese in 2002, in metric tons.

August	September	October	November	December
4,021	2,740	1,136	284	2

Even if one assumes a maximum trade impact from the safeguard action, the impact on U.S. prices for cheese and/or milk is likely to have been very small. For comparison, on an annual basis, U.S. cheese consumption is just below 4 million metric tons or approximately 330,000 tons per month.

The safeguard action raised minimal reaction from trading partners, likely due to the trade pattern shown above, which indicates a high probability that only a small quantity of potential trade was actually affected.

Dairy promotion check-off and imports

Question:
The 2002 Farm Bill directed the Department to begin to require that dairy importers pay into the research and promotion as U.S. dairy farmers currently do. What is the status of USDA implementation of this requirement?

Answer:
The Department developed a draft proposed amendment to the Dairy Promotion and Research Order to implement assessments on imported dairy products as required by the

2002 Act. The proposal is currently under review.

MPC imports

Question:
What do you estimate the increase in milk prices would be if border controls such as those included in H.R. 1160 were adopted?

Answer:
MPC imports' impact on dairy markets is to lower NDM prices, or when NDM prices are being supported by MPSP, to increase CCC purchases of NDM. During MPC import growth, domestic NDM prices have typically been near support and CCC has purchased significant quantities of NDM. MPC imports have supported new product formulations and, to some extent, increased CCC NDM purchases. Direct impacts on farm prices are believed to be very small because of the MPSP. Exclusion of MPC imports would reduce, but not eliminate, CCC NDM purchases so price impacts would be minimal.

Testimony of

Charles Ahlem

before the

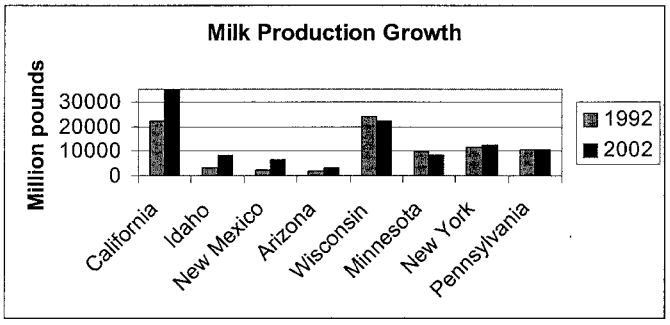
U.S. House of Representatives

Subcommittee on Department Operations, Oversight, Nutrition and Forestry

May 20, 2003

I am Chuck Ahlem, a dairyman from Hilmar, California. I am the owner/operator of Charles Ahlem Ranch, a 2,000-cow dairy farm, and am a part owner of Hilmar Cheese Company. I began dairy farming in 1975 with 100 cows. I am a graduate of California State University, Fresno, with a BS in Dairy Science. Among other affiliations, I am a member of the USDA Ag Trade Policy Committee (APAC), board member of the State Board of the California Department of Food and Agriculture, board member of California Dairy Council, chairman of the California Dairy Quality Assurance Program, and board member of the California Milk Advisory Board.

There is no question that milk production continues to move westward in the United States. In the past decade alone (1992-2002), milk production in Idaho has increased 160 percent, California has increased 58 percent, New Mexico has increased 191 percent and Arizona has increased 92 percent. At the same time, milk production in the traditional dairy states of Wisconsin and Minnesota has actually decreased by 7 and 14 percent respectively. Pennsylvania and New York have increased production by just 4 and 6 percent. The move west has been driven by climate, availability of land, improved infrastructure, urban pressure, and, ultimately, lower cost of production, among other reasons. Processing capacity has "followed the milk." The growth in dairy manufacturing capacity in the West has paralleled the growth in milk production because it is more efficient to transport finished product than raw milk.



Source: *Milk Production, Disposition and Income*, National Ag Statistics Service, 2003.

Economies of scale, economies of scope, labor specialization and other economic factors are driving dairy farms to be become larger, just as those same economic factors have encouraged consolidation in other industries. There is still a place for small farms that develop marketing niches or production specializations. I expect to see a settling out of herd sizes because dairymen will want to spread their risk. I don't believe that 10,000-cow herds will be the norm because of such risks as disease and bioterrorism.

Government policy should not interfere with the marketplace. The government has sent the wrong signals—that there is an unlimited demand for commodity dairy products. Without this interference, dairymen would produce milk that would be made into products that the marketplace demands. However, the current signals from the government to dairymen are to produce milk, regardless of the demand for dairy products. This is exactly what the MILC program has done.

Policy should focus on programs that allow dairymen to help themselves and contribute to long-term sustainability in real markets. I prefer voluntary and self-initiated industry programs over government mandated programs. Government dairy policy has been an evolutionary process. Because of this, policy has been layered upon policy and has resulted in an economically intrusive structure. The entire structure deserves a hard look and ways must be found to allow markets to work properly. Dairy producers need to receive accurate market signals—ones that encourage not only appropriate production levels but also product innovation and market expansion.

Rather than focusing on economically intrusive policies, the industry would be better served by an examination of other policies that affect the long-term viability of a domestic industry, such as environmental sustainability, product development, tax structure, land and water allocation, and other "non-market" issues. For example, the current tax structure is a huge disincentive to exit the dairy industry. Even those dairymen who want to discontinue dairy farming have difficulty doing so because of the tax penalties they face by exiting the business. If a dairy farmer wants to diversify, he faces tax consequences of shifting assets from one crop (milk) to another. A more equitable tax policy would enable farmers, including dairymen, to respond more quickly to market signals by improving their ability to switch production to higher value crops.

While the U.S. dairy industry is experiencing a shift in structure, it is a natural progression of business. The current price slump is not due to a shift in infrastructure, but rather to the natural supply cycle. Unfortunately, government intervention, in the form of the MILC, is prolonging depressed prices. While this normal down cycle of prices would ease as dairymen cut back production to reduce expenses or decided to exit the business, now the injection of artificial income in the form of MILC is encouraging overproduction. This oversupply of milk is continuing to depress prices. A recent Food and Agricultural Policy Research Institute (FAPRI) analysis clearly indicates that the MILC has interfered with the marketplace and has, in fact, caused a net decrease in dairy farmer income in my home state of California because MILC payments have not been able to offset the decrease in prices caused by their marketplace interference. The MILC is very damaging to the industry and should end immediately.

FAPRI Analysis—
Change in dairy farm revenue (per cwt) expected from elimination of MILC
(as compared to FAPRI March 2003 baseline, if MILC would have been eliminated 1/1/2003)

	2003	2004	2005
California	0.05	0.17	0.24
Idaho	-0.03	0.10	0.17
New Mexico	0.16	0.28	0.35

Source: *The Effect of the United States Dairy Industry of Removing Current Federal Regulations*, Table 3, Scott Brown, FAPRI, University of Missouri, 2003.

Although removal of MILC would result in short-term decrease in producer income in some other states (because of removal of the MILC income), FAPRI's projections indicate that income in those states would actually increase relative to the baseline in future years. By 2006, dairy income for all areas would increase by 23 to 25 cents, meaning the increase in milk prices caused by appropriate levels of production would more than offset the elimination of MILC payments.

FAPRI Analysis—
Change in dairy farm revenue (per cwt) expected from elimination of MILC
(as compared to FAPRI March 2003 baseline, if MILC would have been eliminated 1/1/2003)

	2006	2007	2008
Wisconsin	0.23	0.15	0.10
Minnesota	0.23	0.15	0.10
New York	0.24	0.15	0.10
Pennsylvania	0.24	0.15	0.10

Source: *The Effect of the United States Dairy Industry of Removing Current Federal Regulations*, Table 3, Scott Brown, FAPRI, University of Missouri, 2003.

I generally support the Federal Milk Marketing Order (FMMO) system as well as individual state orders as long as they do not cause undue marketplace interference. Regulated prices set by these systems must be as low as possible so that the marketplace can send the right signals above that price. Minimum pricing should be just that, minimum. The market must be allowed to work so that dairy producers receive the proper economic signals on what and how much to produce. I do appreciate the oversight that these regulated systems provide.

I generally approve of the Dairy Price Support Program as long as it is a true safety net and not an artificial price enhancement tool. The support program should not be used to eliminate short-term market fluctuations, but rather to provide long-term stability. The only way that the support program can operate effectively is if the Secretary makes timely adjustments to the butter-powder "tilt" in response to market conditions and develops more efficient methods of sales transactions for cheese. The government should not be any processor's regular customer. In fact, government purchases and distribution of non-fat dry milk to livestock producers has depressed the whey market and unintentionally driven down producer income derived from whey sales.

While I support FMMOs and the price support program, I also believe that we now have strong, viable producer entities that could work together to provide the same functions provided by those government programs. When the FMMO system and support program came into being, producer-owned entities were small and ineffective. That is not true today. Large, multi-billion dollar cooperatives and producer organizations have the size and resources to work together to market product, oversee milk movement, set market prices and perform other functions now provided by FMMOs and the support program.

When used appropriately, the Dairy Export Incentive Program is also an effective tool to create long-term market opportunities. I do not support a dump-and-run philosophy to exporting, but rather the building of long-term, sustainable customer relationships. To the extent that DEIP can assist with this, it can be a valuable asset to the industry. It should not be used as a short-term domestic price enhancement tool.

Experience in working with state and local governments has illustrated that the industry can work in conjunction with legislatures and regulatory agencies. As chair of the California Dairy Quality Assurance Program, I have seen firsthand how the industry and governments can work together to find solutions. Our program has developed a good working relationship with agencies such as EPA to find common ground in developing solutions. Government funding for activities such as this environmental program is much more important to the long-term viability of dairymen than having government dollars artificially injected into the marketplace. Other successful uses of funding are seen in the university system to advance science, technology, research and cooperative extension. These types of policy need to continue.

For example, there is a need for funding in areas such as the Western Institute for Food Safety and Security (WIFSS) to develop rapid testing for pathogens and biologicals. There is currently a terrible shortfall in the ability to perform the types and quantities of testing that would be necessary in the event of an outbreak or bioterrorist attack. The WIFSS is a partnership between the California Department of Food and Agriculture, UC Davis and the California Department of Health Services. This program is a step forward in advancing food safety and controlling animal disease. But, programs like this need funding to succeed.

Rather than using the nearly $6 billion that the MILC program is expected to cost on direct payments to dairymen, those limited government resources could have been spent on programs like WIFFS, or environmental and conservation programs, research and development of new dairy products, expansion and penetration of markets, or improved technology. We clearly need more investment in those areas than we do in creating a larger milk supply that is made into products that sit in government warehouses. Too much milk creates a massive cloud over all dairy markets.

It is clear from current market conditions that the government is not, and should not be, the solution. There will never be enough money in government coffers to keep every dairy farmer in business with market payments, so the prudent use of funds targeted toward long-term sustainability, not short-term market fixes, is critical.

Testimony of Brian Boehning
Review of the Current State of the Dairy Industry
Before the Subcommittee on Department Operations, Oversight, Nutrition and Forestry
U.S. House Committee on Agriculture
May 20, 2003

My name is Brian Boehning and my wife, Tiffany, and I own and operate a family dairy operation near Muleshoe, Texas. While I am a member of Dairy Farmers of America, the views I will present today are my own and do not necessarily reflect the views of DFA. Nonetheless, I believe my opinions are generally reflective of the views of most dairy farmers in the Southwestern United States regardless of which coop markets their milk

I was born and raised in West Texas. I started a small dairy farm southwest of Canyon, Texas in 1990. Two years later I moved to my current location in Muleshoe, Texas where I currently operate a 2800-cow dairy and farm 2500 acres of irrigated land to grow feed for the cows and their replacement heifers.

Chairman Gutknecht and Ranking Member Dooley, my compliments to you for calling this hearing to examine the general state of the dairy industry:

Though it is not a good time to be a dairy farmer, I do not necessarily believe that government can or should be the salvation of dairy farmers. Sometimes the "help" is the problem. While government can play a critical role in the stabilization of milk prices and the dairy economy, that role should be limited. Now dairy producers are experiencing problems when government does more in the dairy economy than it should. I appeal to you to curtail the financial assistance you are providing the dairy industry through the MILC Program because those payments are leading to depressed milk prices nationwide.

As you know, my industry, under the leadership of National Milk Producers Federation, has initiated a self-help program to alleviate the problems caused by an oversupply of domestic and imported milk products. This does not involve the government. While I support the CWT concept, government programs and inaction fight against these actions of producers.

Producers cutting back on domestic production to resolve an oversupply problem due in part to a growing level of dairy product imports will be futile if Congress doesn't address the dairy import situation. Without Congressional action to curtail the MILC Program and at least hold dairy imports to current levels, implementing the CWT program will be like throwing water to a man in a sinking boat.

What dairy farmers like me need more than anything are markets, not government markets for powder that consumers do not want, but for bottled milk, cheese, ice cream and the like. A growing domestic market has developed for milk protein concentrates. These are showing up in nutrition bars, power drinks, and other commodities. It is apparent that consumers want MPC. In response to that, my coop, DFA has built an MPC plant in Portales, NM. Also in the Southwest, Select Milk Producers operates several wet MPC plants with ultra filtration. A

government program that encourages overproduction of an unwanted product – while there is a market for new products that the government does not support – is nonsense.

Government action can help here. Bringing MPC imports under the same tariff rate quotas as other similar dairy products will create a fair domestic environment that will assist in the development of a domestic supply.

In short, the government pays some producers billions of dollars to keep some producers producing milk, the same government subsidizes plants to make product that consumers do not want and at the same time lets imports fill the market demand with cheaper imports. Each fights the other.

The problem with government payments and programs is not just that it hurts the prices, but, and this is its worse problem, it hurts producers' will to do for themselves and work with each other.

The MILC Program is a poorly designed and costly program put in place largely to replace the Northeast Interstate Dairy Compact. In spite of warnings of some dairy farm representatives that the MILC Program would greatly exceed cost estimates and depress prices on all producer milk, we were told the program's adoption was a necessary evil to reach a consensus on the farm bill.

The Northeast Dairy Compact was market-distorting in that region, but the amount of milk covered was small enough not to have a big impact on the national market. However, due to the national nature of the MILC Program, the impacts have been greater and a segment of the dairy production sector has not received the market signal that lower milk prices have been sending since the end of 2001. Since December 2001 the Class I mover has averaged only $10.78/cwt (a low price level) but producers who get MILC Program payments on all of their milk have averaged $12.09/cwt.

The MILC Program sends signals to overproduce while the dairy price support program requires the government to buy the product as it is overproduced. This situation will cause continued low dairy prices even after the MILC Program is over because of inventory build-up. This will also cost the government to spend billions of dollars on the dairy industry in years to come.

The MILC Program is causing lower milk prices for all sizes of dairies in all regions of the country. In the 15-month period beginning in January 2002 and ending in March 2003, Class III prices averaged $10.24/cwt. In the same time period, Class III prices and MILC Program payments on 100% of a producer's production totaled $11.63/cwt. The 5-year average Class III price is $12.15/cwt. So even producers eligible for MILC Program payments on all of their production are receiving $.52/cwt. less than the 5-year average.

This program negatively affects the income of average producers while devastating the income of producers with above-average production. More of the same is forecast for the future by most dairy economists and price forecasters. No one at this time is predicting a single month in which the payment will not be available.

The target price selected for the program is really the root of its price-depressing effect. The $16.94/cwt. Class I Boston price -- which for comparison purposes translates to a $13.69/cwt. Class III price -- is too high. From 1998 through the end of 2002, the Boston Class I price was above the target price less than 28% of the time. This guarantees the program will be in effect more often than not. It is a price enhancer, not a safety net. This target price is too high and sends a signal to produce more milk even during overproduction conditions like those we face today. The research that has been done by several respected dairy economists shows the MILC Program has and will continue to hold milk prices at historically low levels.

Another problem is the payment cap. Payments are only eligible on 2.4 million pounds of production per year. The average dairy in the United States produces 2.3 million pounds annually. Therefore, this program puts the entire burden of reduced prices caused by overproduction on the shoulders of producers with above-average production. Their response, in order to maintain cash flow and profitability will be even more production. The cycle goes around again.

The dairy industry has had a support price for the last decade or so in the range of about $10.00. Currently, it is at $9.90. In the past, when Class III prices were at or near support levels for two to six months, economics would cause producers to adjust their operations, feeding, breeding, culling, or even retiring altogether. Then supply would correct itself without the government buying very much product. This trend caused dairies to get larger and more efficient. The MILC Program goes against this twenty-year dairy industry trend.

In the meantime the MILC Program drops prices on the milk I and my neighbors produce while other producers receive a subsidy to cover the loss. If the government is going to lower milk prices, it should compensate all producers on all of their milk. We do not have the ability to make up these losses in the market place.

To put the MILC Program payment cap in perspective, a crop farmer and his wife could receive approximately $150,000 a year in farm program payments the last several years on a business with far less gross income than most dairies being built today. The effective payment limitation on MILC Program payments has been close to $43,000. From another perspective, if a 2,000-cow herd (a typical farm in the Southwest) were to receive MILC Program payments without a cap for the year 2002, this dairy would receive a MILC Program payment of approximately $520,000. When we put the MILC Program maximum payment level in this context, it is easy to see it was set at a completely unreasonable level.

From the early 80s to the early 90s, the dairy support price level – the price at which the Commodity Credit Corporation (CCC) purchases surplus dairy products – slowly dropped from $13.00/cwt. to the current $9.90/cwt. This decrease in support level was implemented slowly to give the industry time to adjust, unlike the MILC Program, which was sudden and unexpected.

When the 2002 Farm Bill was adopted, the Congressional Budget Office (CBO) estimated the total cost of the MILC Program at $1.3 billion for the entire life of the five-year program.

Latest reports that I saw showed that USDA has already paid dairy farmers $1.25 billion through April 1. Fiscal Year 03 spending is projected at $2.1 billion. In March, CBO upped its estimate for the total cost of the MILC Program to $4.2 billion – more than three times the price tag this Committee agreed to last summer. If I ran my dairy this way, my banker would be at my doorstep asking for the keys.

To put this in better perspective, from 1998 through the end of 2000, the average total dairy program cost to the government has been less than $500 million per year. 2003 alone is projected to cost $2.9 billion. It is obvious this program is cost-prohibitive.

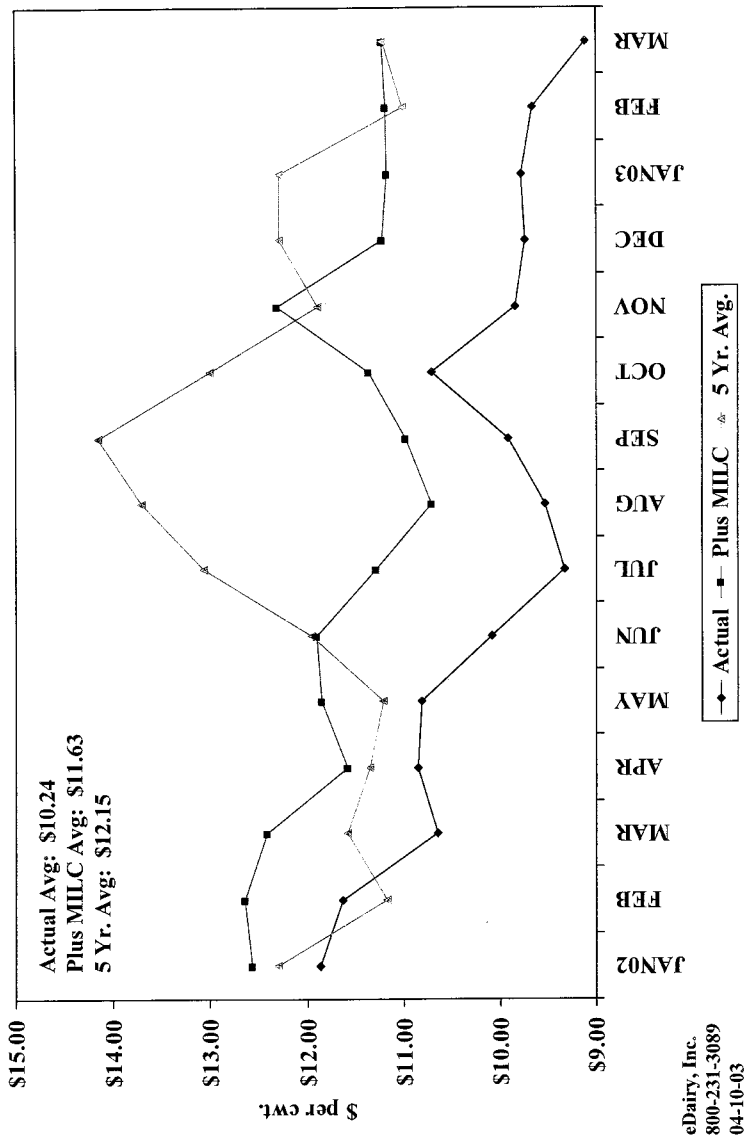
Most dairy economists believe MILC Program payments will continue to hold milk prices down for years to come because the MILC Program and dairy price support programs cannot co-exist.

The MILC program has its problems. It needs to be either eliminated totally, or the target price needs to be lowered significantly so as to not stimulate production and the cap needs to be eliminated. Under its current structure, MILC is cost-prohibitive to the government and causes overproduction that negatively affects income for all sizes of dairy farms.

In conclusion, I would like to reiterate that: 1) MILC is cost-prohibitive to the government; 2) MILC promotes inefficiency; 3) MILC holds milk prices at low levels which lowers the milk price to producers with average production, but at the same time devastates the income of producers with above average production.

The CWT is not the only thing that producers are doing to help themselves. We in the Southwest have benefited the last several years from the Southwest Milk Marketing Agency. The cooperative agreement between DFA, Select, Zia, and Lone Star Milk is one where producers collectively market all of the milk in the area. Between efficiencies in transportation, administration, and marketing as well greater bargaining strength, this producer cooperation has put money into producers' pockets without the government being involved. If we can successfully do it ourselves why should we have the government come in and mess it up?

Thank you for giving me this time to share my views on the dairy situation.


Selected Class III Milk Prices
Actual Avg: $10.24
Plus MILC Avg: $11.63
5 Yr. Avg: $12.15
$ per cwt.
$15.00
$14.00
$13.00
$12.00
$11.00
$10.00
$9.00
JAN02
FEB
MAR
APR
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC
JAN03
FEB
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Actual
Plus MILC
5 Yr. Avg.
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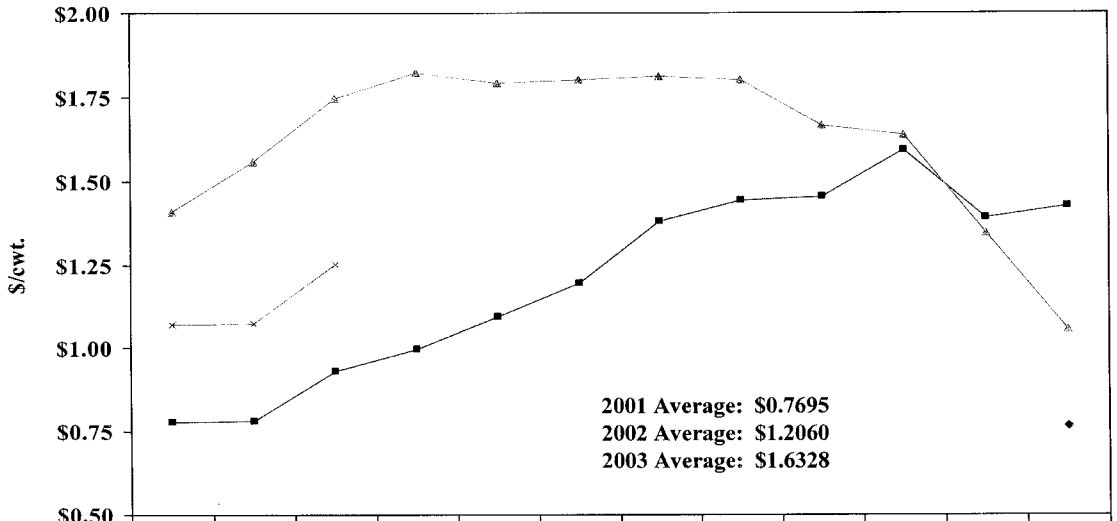
MILC Program Payment Rate Actuals & Forecasts



	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2001												$0.7695
2002	$0.7785	$0.7830	$0.9315	$0.9990	$1.0935	$1.1970	$1.3815	$1.4445	$1.4535	$1.5930	$1.3905	$1.4265
2003	$1.4085	$1.5570	$1.7460	$1.8225	$1.7910	$1.8000	$1.8135	$1.8000	$1.6650	$1.6380	$1.3455	$1.0575
2004	$1.0710	$1.0755	$1.2510									

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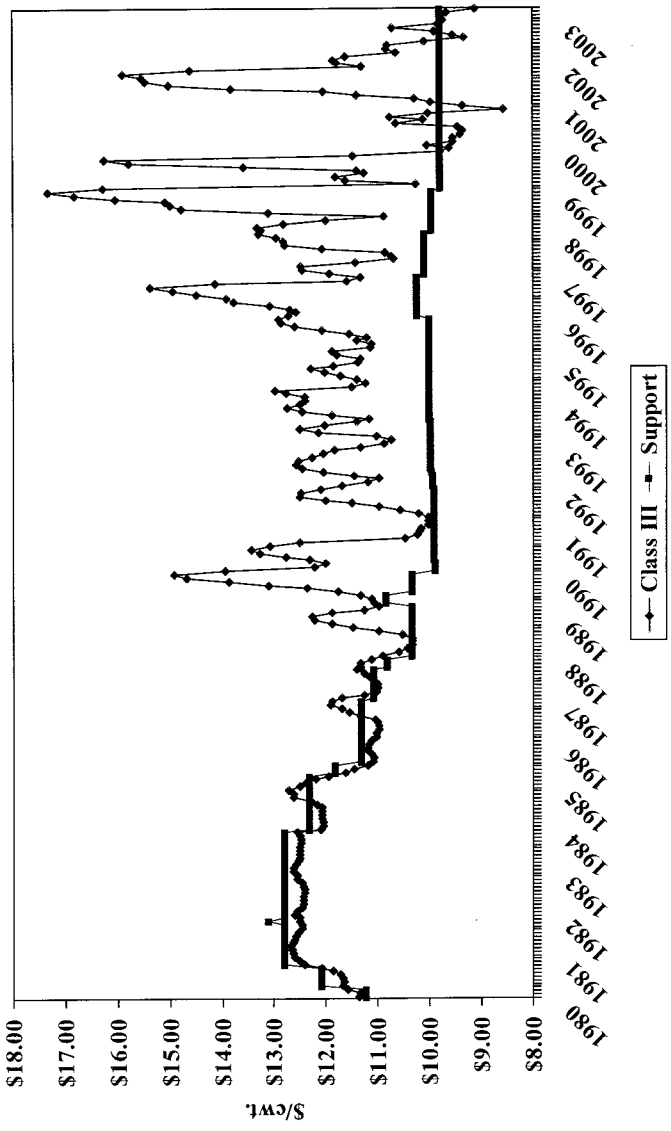
Class III Milk Price
$/cwt.
$18.00
$17.00
$16.00
$15.00
$14.00
$13.00
$12.00
$11.00
$10.00
$9.00
$8.00
1980
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Class III
Support
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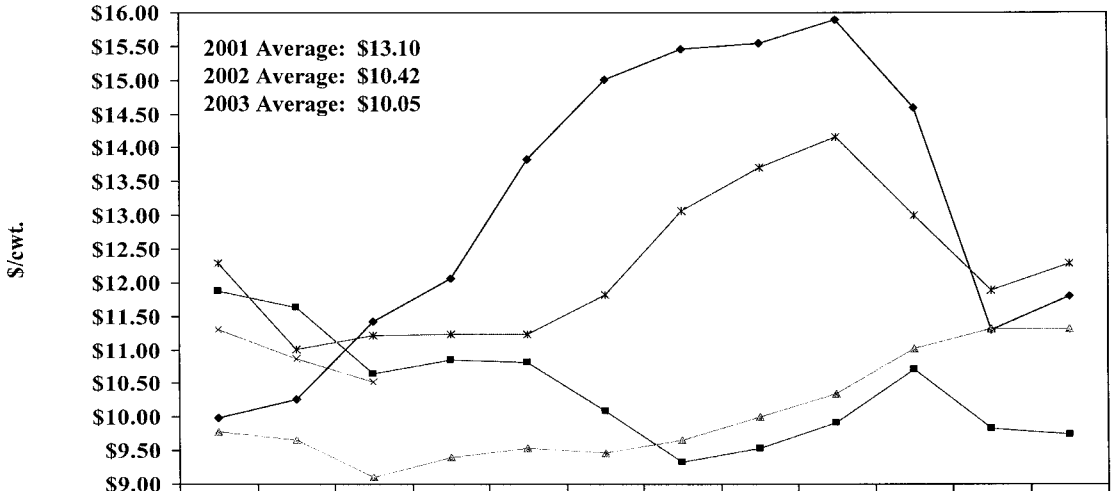
Class III Actuals & Forecasts



	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2001	$9.99	$10.27	$11.42	$12.06	$13.83	$15.02	$15.46	$15.55	$15.90	$14.60	$11.31	$11.80
2002	$11.87	$11.63	$10.65	$10.85	$10.82	$10.09	$9.33	$9.54	$9.92	$10.72	$9.84	$9.74
2003	$9.78	$9.66	$9.11	$9.40	$9.54	$9.46	$9.65	$10.00	$10.36	$11.03	$11.33	$11.33
2004	$11.30	$10.87	$10.52									
98-02 Avg.	$12.29	$11.01	$11.21	$11.23	$11.23	$11.82	$13.07	$13.71	$14.16	$13.00	$11.89	$12.29

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Statement by Scott Brown

Dairy Economist for the

Food and Agricultural Policy Research Institute (FAPRI) at the

University of Missouri

Before the House Agriculture Subcommittee on

Department Operations, Oversight, Nutrition and Forestry

Tuesday, May 20, 2003

Mr. Chairman and Members of the Committee, thank you for the opportunity to be here today to discuss the current state of the dairy industry. My remarks will focus on how policy, trade, and supply and demand factors have been important in determining today's market situation for the dairy industry. In my remarks today, I will not condone nor condemn any of the current policies in place in the dairy industry. The institute that I am a part of, the Food and Agricultural Policy Research Institute (FAPRI) strives to remain an unbiased, objective unit that stands ready to provide Congress with a quantitative assessment of any agricultural policy alternative.

The dairy industry is experiencing some of the lowest milk prices since the late 1970s. USDA's preliminary estimate of the April all milk price is $10.90 per cwt. This is a decline of over $1.50 per cwt relative to the year earlier level, and more than $2.00 per cwt relative to the past five-year or ten-year average for April. Many factors are responsible for the current milk price situation. Demand for dairy products has been soft since late 2001 due in part to weaker general economic outlook than many experts had expected. Commercial disappearance on a milkfat basis grew only 0.5 percent in 2002 while on a skim solids basis disappearance actually fell by 0.3 percent. Although there may be some signs that demand for dairy products is starting to turn around, commercial stocks of dairy products will need to be drawn down before prices can rise.

The supply side of the picture has also contributed to low milk prices. Milk production expanded by 2.7 percent in 2002 in response to the $15 per cwt annual average milk price

producers are hurt as increased milk supplies caused by the MILC program reduce milk prices. For large producers, the decline in the market price for milk outweighs the MILC payment they receive on their first 2.4 million pounds while for smaller producers the MILC program payment more than offsets the decline in the market price of milk. Using the FAPRI aggregate analysis of the MILC program, Agriculture Food and Policy Center (AFPC) researchers at Texas A&M University suggest that until a dairy operation reaches about 600 head, the benefits of the MILC program exceed the loss from lower milk prices that result from the MILC program.

The FAPRI analysis of an expanded MILC program that covers every pound of milk produced shows that the market effects of such a program could be quite large. Milk prices could decline by over $1 per cwt under such a program and government outlays under the program could top $2.5 billion annually. The analysis of this this program alternative suggests that the parameters under which the MILC program operates are critical. Perhaps even more important is the compatibility of different aspects of federal dairy policy. The MILC program and price support program can create a chronic problem for the dairy industry if parameters of these programs are set at levels that encourage long term surplus production of milk.

The dairy price support program has been a key component of dairy policy for many years. If the price support program is eliminated, FAPRI analysis suggests that in the short run milk prices would decline by nearly $0.40 per cwt. Longer term milk prices return to baseline levels as milk production adjusts to elimination of the program. The analysis results of this feature of federal dairy policy rest on how the Secretary of Agriculture chooses to eliminate government owned dairy products and the level of world market prices of dairy products.

Although FAPRI analysis shows only small effects of eliminating the price support program after the first two years, it is important to note that the current price support program does provide a safety net in circumstances where milk supplies exceed demand needs. This can be critical in a market where demand for the product is rather inelastic.

Changes in the federal milk marketing order system dominated much of the dairy policy debate of the late 1990s. Further modifications to the federal order system continue to be debated by the industry. These debates focus on both the number of orders and classes of milk needed in the federal order system. Any quantitative analysis that looks at large changes in the federal order system remains difficult to conduct. Data limitations require large assumptions to be made in an attempt to quantify the impact of the change in federal orders. FAPRI analysis that looks at complete elimination of the federal order system highlights the regional battles that will unfold as federal order changes are made.

Thank you for the opportunity to address these critical issues for the dairy industry. I look forward to answering your questions.

received in 2001. Thus far in 2003, milk cows have remained near 9.15 million head and have yet to contract in response to the current low milk prices.

Although dairy product trade has caught the attention of many in the dairy industry, changes in the trade picture are not a major factor in the current outlook situation. Imports of milk protein concentrates probably have displaced some domestic nonfat dry milk use but it has not had a large negative impact on milk prices. Further research is needed to understand some of the functionality issues that result in the use of milk protein concentrates instead of nonfat dry milk in some food products.

Current FAPRI projections would suggest that milk prices will rebound in the second half of 2003 but will remain low by historical standards. Recent increases in dairy cow slaughter should begin to impact milk supplies in the coming months and allow for some strength in milk prices. Sustained growth in dairy product demand would also provide a boost for milk prices.

With respect to some of the longer-term market and policy issues, FAPRI has recently completed a broad examination of current federal dairy policy in a report attached to my testimony. The research examines the Milk Income Loss Contract (MILC) program, the dairy price support program, the Dairy Export Incentive Program (DEIP) and Federal Milk Market Orders (FMMOs). The "corners" approach taken in this research helps to frame the debate about the impact of federal dairy policies.

The MILC program has received considerable attention in the wake of recent low milk prices. Some have argued that the MILC program is responsible for the current milk price declines. It is clear that the MILC program does lower milk prices as producers respond to the additional payments made under the program. However, the current FAPRI estimate shows the all milk price would be only $0.25 per cwt higher in 2003 in the absence of the MILC program suggesting that much of the current decline in milk prices is due to factors other than the MILC program. In terms of the current outlook, the MILC program likely prolongs adjustment in milk supplies to the current low milk prices.

To date, over $1.3 billion has been sent to milk producers under the MILC program. Current FAPRI estimates suggest that during the life of the MILC program outlays will reach $4.8 billion. With the 2.4 million pound marketings cap on payments, the MILC program benefits small dairy producers. This benefit can be seen in the state-by-state MILC outlays, as nearly 20 percent of total MILC outlays have gone to Wisconsin producers whose milk production represents 13 percent of the nation's milk supply. Alternatively, California producers have received 8 percent of total MILC outlays while producing 21 percent of the nation's milk supply. Current NASS estimates show that the average dairy herd in Wisconsin has just over 70 cows while in California the average dairy herd is over 650 cows.

The MILC program has offsetting effects on producer income. On one hand, producers benefit from the direct government payments they receive on up to 2.4 million pounds of milk marketed when Boston class I prices fall below $16.94 per cwt. On the other hand,

The Effect on the United States Dairy Industry of Removing Current Federal Regulations

Scott Brown
FAPRI – University of Missouri

The Food and Agricultural Policy Research Institute (FAPRI) has provided Congress quantitative analysis of policy alternatives since the 1980s. The majority of the FAPRI analysis has been conducted on a particular policy alternative under consideration as Congress debate farm policy change. Focusing on the quantitative effect of one policy alternative does not allow for a broader view of the effect that an entire set of policies has on an agricultural sector.

The objective of this work is to provide a layer-by-layer dissection of the effect that each current major federal dairy policies has on the dairy industry. This approach allows for the measurement of both the effect of one piece of current policy and the effect that combinations of current policy have on the dairy industry. The major features of dairy policy analyzed are the Milk Income Loss Contract (MILC) program, the dairy price support program, the Dairy Export Incentive Program (DEIP), and Federal Milk Market Orders (FMMOs). This analysis does not cover any changes in state-level dairy regulations that are currently in place.

The scenarios shown in this analysis should not be interpreted as likely outcomes for dairy policy change. In many cases, these scenarios represent "end points" or "corners" of policy choices. They are meant to frame the debate for a particular policy option.

These policy alternatives are run with the FAPRI dairy model that is documented in FAPRI-UMC TDR # 01-03. The FAPRI dairy model is a set of over 350 structural equations that attempt to capture the important economic relationships that exist in the U.S. dairy sector. The supply side of the model is handled at the state-level while the demand portion of the model is national.

FAPRI Dairy Baseline

The analysis will be a forward-looking examination (2003-2012) of what the dairy industry may look like if each of the regulations that are the focus of this work is removed. The yardstick that will be used to measure the effect of eliminating these policies is the March 2003 FAPRI baseline. A full description of the domestic baseline covering many agricultural commodities can be found in the "FAPRI 2003 U.S. Baseline Briefing Book," FAPRI-UMC Technical Data Report 04-03, March 2003. This report can be found on the FAPRI website at www.fapri.missouri.edu.

The domestic dairy baseline is driven in part by expected feed prices and information about the general economic outlook. Equally important to the baseline for the domestic dairy industry are assumptions related to current policy. The March baseline assumes that the price support program and FMMOs remain in place for the life of the baseline. The MILC program expires September 30, 2005, as legislated in the 2002 farm bill, and is capped at a producer's first 2.4 million pounds of marketings. The baseline assumes that producers do not reorganize their operations to qualify more of their milk for the MILC program. This leads to a baseline

assumption that 58.5 percent of the milk produced in the U.S. is eligible for MILC payments. The percentage of milk eligible for MILC payments varies greatly on a state-level basis. This baseline assumes full use of the DEIP for nonfat dry milk but no DEIP use in cheese or butter markets. Current import trade restrictions remain in place throughout the baseline. This baseline assumes no butter/non fat dry milk tilts will occur in support prices for these products.

An overview of the dairy baseline is shown in Table 1. This baseline projects that U.S. all milk prices remain at or below $13 per cwt. during the baseline. The baseline shows that milk prices increase at a faster pace after the MILC program ends. Milk prices are projected to grow slower than previous baselines primarily as a result of the slower growth in domestic cheese consumption projected in this baseline. Nonfat dry milk prices remain at the government purchase price throughout the baseline as government stocks of nonfat dry milk remain burdensome. Both butter and cheese prices increase over the baseline as growth in demand for those products remains slightly ahead of the growth in supply. Government outlays for the dairy industry are expected to top $2.5 billion in fiscal year 2003 as retroactive payments under the MILC program and many of the 2003 MILC payments fall in fiscal 2003. The annual cost of the MILC program is expected to average $1.5 billion.

Table 1. Summary of the FAPRI March 2003 Dairy Baseline

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Dairy Cows (thou. head)	9,067	9,011	8,965	8,896	8,841	8,801	8,768	8,741	8,718	8,700
Milk Yield (lbs.)	18,884	19,179	19,462	19,714	19,991	20,268	20,534	20,791	21,043	21,291
Milk Production (bil. lbs.)	171.2	172.8	174.5	175.4	176.7	178.4	180.0	181.7	183.5	185.2
All Milk Price ($/cwt.)	12.19	12.24	12.27	12.52	12.58	12.71	12.73	12.81	12.91	13.00
MILC Payment ($/cwt.)	1.22	1.18	1.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Class III Price ($/cwt.)	10.98	11.07	11.11	11.37	11.45	11.59	11.63	11.73	11.85	11.96
Class IV Price ($/cwt.)	10.49	10.50	10.55	10.85	10.91	11.06	11.06	11.12	11.20	11.26
Cheese Price ($/lb.)	1.25	1.25	1.26	1.28	1.29	1.30	1.30	1.31	1.33	1.34
Butter Price ($/lb.)	1.19	1.25	1.26	1.33	1.35	1.38	1.39	1.40	1.42	1.43
Nonfat Dry Milk Price ($/lb.)	0.84	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81
Per Capita Consumption (lbs.)										
Cheese	30.1	30.5	30.8	31.0	31.2	31.4	31.7	32.0	32.3	32.5
Butter	4.7	4.6	4.6	4.5	4.5	4.4	4.4	4.4	4.3	4.3
Nonfat Dry Milk	3.3	3.4	3.4	3.4	3.5	3.5	3.5	3.5	3.6	3.6
Fluid	207.8	207.9	207.5	206.4	205.3	204.3	203.7	203.2	202.9	202.5
Net Removals (mil. lbs.)										
Nonfat Dry Milk	457	367	341	292	267	268	250	228	206	187
Gov't Outlays (mil. $, fiscal year)	2,586.4	1,524.4	1,501.3	579.9	268.0	271.9	259.9	244.1	226.5	210.0
MILC Program	2,205.8	1,200.9	1,188.4	296.6	-	-	-	-	-	-
Other	380.6	323.5	313.0	283.2	268.0	271.9	259.9	244.1	226.5	210.0

MILC Program

The first piece of dairy policy examined is the MILC program. To provide a broader view of the impacts of the MILC program, three separate scenarios are included. The first scenario (MILC) extends the MILC program for the life of the baseline. The second scenario (MILC+) extends the MILC program for the life of the baseline and removes the 2.4 million pound cap on producer marketings eligible for the payment. The final scenario (No MILC) is elimination of the MILC program.

It is important to recognize that the assumed participation rates used in the baseline are crucial in determining how states fare under the alternatives shown here. The actual level of participation in each state remains unclear. Although some data is beginning to surface regarding state-level MILC program payments, it is by no means final. For example, some potential participants have not signed up yet recognizing they will still be eligible for retroactive payments under the program. The assumption that 58.5 percent of milk marketed in the United States is eligible for a direct payment results from summing eligible milk in each of the major states. The early data recently available would suggest U.S. participation to date is less than assumed in the baseline. The amount of eligible milk in each state was calculated by looking at the size of operation information contained in milk production reports. This approach in determining participation is not exact. The assumption of the percent of milk eligible for a direct payment in each state is: California, 17; Wisconsin, 85; New York, 77; Pennsylvania, 90; Minnesota, 85; Idaho, 24; New Mexico, 8; Michigan, 70; Washington, 29; and Texas, 47. The baseline assumes no reduction in each states eligible milk percentage over time even though continued structural change would suggest a reduction should occur. On the other side of the equation is the notion that over time additional leakage around the 2.4 million pound cap could occur.

The three scenarios chosen to examine the MILC program provide a broad examination of the program's effects. The MILC scenario provides an examination of the longer run impact of the current program since the baseline only has the MILC program in place through September 30, 2005. The MILC+ scenario allows analysis of a program that behaves quite differently from the current MILC program since there is no cap on eligible milk. In addition, this scenario provides information on how the MILC program would affect the dairy industry if the 2.4 million pound marketings cap could be worked around through reorganization of producers' operations. The remaining scenario, NoMILC, shows how the industry would fare without the direct payment program.

The aggregate results shown in Table 2 suggest that each of these scenarios has tradeoffs that occur depending on how much of producer revenue is derived from the market versus direct payments from the government. Not surprisingly, the largest level of milk supplies occurs under the MILC+ scenario. This result occurs because the government is making direct payments on all milk marketed which gives the largest net revenue increase. In addition, the MILC+ run shows the largest level of government outlays, averaging $2.8 billion per year over the 2008 to 2012 period.

At the other end of the spectrum is the NoMILC scenario. This scenario results in the lowest level of milk production and the lowest level of government outlays. Over the 2008 to 2012 period, government outlays under this option average only $0.2 billion per year. This cost is associated with running the price support program and the DEIP. Milk production averages 200 million pounds below the baseline over the 2008 to 2012 period.

Table 2. Summary of the Impacts of Alternative MILC Program Options on the U.S. Dairy Sector

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
Milk Production (bil. lbs.)												
Baseline	171.2	172.8	174.5	175.4	176.7	178.4	180.0	181.7	183.5	185.2	174.1	181.8
MILC	171.2	172.8	174.5	176.2	177.9	179.7	181.5	183.2	185.0	186.7	174.5	183.2
Δ From Base	0.0	0.0	0.0	0.8	1.1	1.3	1.4	1.5	1.5	1.5	0.4	1.4
MILC+	172.0	173.9	175.8	177.6	179.4	181.3	183.2	184.9	186.6	188.3	175.8	184.9
Δ From Base	0.8	1.1	1.3	2.3	2.7	2.9	3.1	3.2	3.2	3.1	1.6	3.1
Δ From MILC	0.8	1.1	1.3	1.5	1.6	1.6	1.7	1.7	1.7	1.6	1.2	1.7
No MILC	170.3	171.7	173.1	174.7	176.3	178.1	179.8	181.6	183.4	185.2	173.2	181.6
Δ From Base	-0.9	-1.2	-1.3	-0.7	-0.4	-0.3	-0.2	-0.1	-0.1	-0.1	-0.9	-0.2
Δ From MILC	-0.9	-1.2	-1.3	-1.5	-1.6	-1.6	-1.6	-1.5	-1.5	-1.5	-1.3	-1.5
Δ From MILC+	-1.7	-2.2	-2.5	-2.9	-3.1	-3.2	-3.3	-3.3	-3.3	-3.2	-2.5	-3.3
All Milk Price ($/cwt.)												
Baseline	12.19	12.24	12.27	12.52	12.58	12.71	12.73	12.81	12.91	13.00	12.36	12.83
MILC	12.19	12.24	12.27	12.28	12.22	12.28	12.26	12.32	12.41	12.50	12.24	12.36
Δ From Base	0.00	0.00	0.00	-0.24	-0.36	-0.43	-0.47	-0.50	-0.50	-0.50	-0.12	-0.48
MILC+	11.96	11.89	11.85	11.80	11.71	11.74	11.71	11.75	11.85	11.95	11.84	11.80
Δ From Base	-0.23	-0.35	-0.42	-0.72	-0.88	-0.97	-1.03	-1.06	-1.06	-1.05	-0.52	-1.04
Δ From MILC	-0.23	-0.35	-0.42	-0.48	-0.52	-0.54	-0.56	-0.56	-0.56	-0.55	-0.40	-0.56
No MILC	12.45	12.61	12.71	12.75	12.73	12.81	12.80	12.86	12.95	13.02	12.65	12.89
Δ From Base	0.25	0.37	0.44	0.23	0.15	0.10	0.07	0.04	0.03	0.02	0.29	0.05
Δ From MILC	0.25	0.37	0.44	0.48	0.51	0.53	0.54	0.54	0.53	0.52	0.41	0.53
Δ From MILC+	0.49	0.72	0.86	0.95	1.02	1.07	1.09	1.10	1.10	1.08	0.81	1.09
MILC Payment ($/cwt.) a/												
Baseline	1.22	1.18	1.16	0	0	0	0	0	0	0	0.71	0.00
MILC	1.22	1.18	1.16	1.15	1.17	1.13	1.13	1.10	1.05	1.00	1.18	1.08
Δ From Base	0.00	0.00	0.00	1.15	1.17	1.13	1.13	1.10	1.05	1.00	0.46	1.08
MILC+	1.32	1.33	1.34	1.35	1.39	1.36	1.37	1.34	1.29	1.23	1.35	1.32
Δ From Base	0.10	0.15	0.18	1.35	1.39	1.36	1.37	1.34	1.29	1.23	0.63	1.32
Δ From MILC	0.10	0.15	0.18	0.20	0.22	0.23	0.24	0.24	0.24	0.24	0.17	0.24
No MILC	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Δ From Base	-1.22	-1.18	-1.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.71	0.00
Δ From MILC	-1.22	-1.18	-1.16	-1.15	-1.17	-1.13	-1.13	-1.10	-1.05	-1.00	-1.18	-1.08
Δ From MILC+	-1.32	-1.33	-1.34	-1.35	-1.39	-1.36	-1.37	-1.34	-1.29	-1.23	-1.35	-1.32
Net Revenue ($/cwt.) b/												
Baseline	12.91	12.93	12.95	12.52	12.58	12.71	12.73	12.81	12.91	13.00	12.78	12.83
MILC	12.91	12.93	12.95	12.95	12.90	12.95	12.92	12.96	13.02	13.08	12.93	12.99
Δ From Base	0.00	0.00	0.00	0.43	0.32	0.23	0.19	0.15	0.11	0.08	0.15	0.15
MILC+	13.28	13.22	13.19	13.15	13.09	13.10	13.07	13.09	13.13	13.18	13.19	13.12
Δ From Base	0.37	0.29	0.24	0.63	0.51	0.39	0.34	0.28	0.22	0.18	0.41	0.28
Δ From MILC	0.37	0.29	0.24	0.20	0.19	0.16	0.15	0.13	0.11	0.10	0.26	0.13
No MILC	12.45	12.61	12.71	12.75	12.73	12.81	12.80	12.86	12.95	13.02	12.65	12.89
Δ From Base	-0.46	-0.32	-0.24	0.23	0.15	0.10	0.07	0.04	0.03	0.02	-0.13	0.05
Δ From MILC	-0.46	-0.32	-0.24	-0.20	-0.17	-0.14	-0.13	-0.10	-0.08	-0.06	-0.28	-0.10
Δ From MILC+	-0.83	-0.61	-0.48	-0.40	-0.36	-0.36	-0.27	-0.23	-0.19	-0.16	-0.54	-0.23
Government Outlays (mil $, fiscal year)												
Baseline	2,586	1,524	1,501	580	268	272	260	244	226	210	1,292	242
MILC	2,586	1,524	1,501	1,498	1,516	1,515	1,512	1,483	1,427	1,366	1,725	1,461
Δ From Base	0	0	0	919	1,247	1,243	1,252	1,239	1,200	1,156	433	1,218
MILC+	3,399	2,664	2,709	2,758	2,831	2,852	2,871	2,844	2,761	2,665	2,872	2,799
Δ From Base	813	1,140	1,207	2,178	2,563	2,580	2,612	2,600	2,535	2,455	1,580	2,556
Δ From MILC	813	1,140	1,207	1,259	1,316	1,337	1,359	1,360	1,335	1,299	1,147	1,338
No MILC	1,639	281	264	257	249	258	251	237	222	207	538	235
Δ From Base	-947	-1,243	-1,237	-323	-19	-14	-9	-7	-5	-3	-754	-8
Δ From MILC	-947	-1,243	-1,237	-1,242	-1,266	-1,257	-1,263	-1,246	-1,205	-1,159	-1,187	-1,226
Δ From MILC+	-1,760	-2,383	-2,444	-2,501	-2,582	-2,594	-2,626	-2,606	-2,540	-2,458	-2,334	-2,564

Baseline - FAPRI March 2003 Baseline, **MILC** - Extend current MILC program through 2012, **MILC+** - Extend MILC program through 2012 and pay on all milk marketed, **No MILC** - Eliminate the current MILC program 1/1/2003

a/ - Payment rate on eligible milk

b/ - Net revenue on all milk produced

In between the MILC+ and NoMILC scenarios lies the MILC scenario. The MILC scenario assumes that on a nationwide basis 58.5 percent of milk marketed is eligible for the MILC payment. Government outlays under the MILC scenario average $1.5 billion per year over the 2008 to 2012 period. All milk prices average $0.50 per cwt. less under the MILC scenario than the baseline. Over the 2008 to 2012 period, total average revenue under the MILC scenario is $0.15 higher than the baseline.

Further examination of Table 2 shows that the short and long run effects of these alternative MILC program scenarios are different. In 2003, the lowest net revenue occurs under the NoMILC scenario at $11.94 per cwt. while net revenue is the highest under the MILC+ scenario at $13.32 per cwt. That is a difference of $1.38 per cwt. However, examination of the last year of the analysis shows that the net revenue difference between the highest and lowest is only $0.18 per cwt. Although the MILC+ scenario shows the highest revenue, the baseline now has the lowest level of net revenue. This reinforces the fact that in the short run, these kinds of programs can have markedly different aggregate impacts. However, once milk supplies have had time to adjust, the aggregate impacts become muted.

Perhaps more interesting than the aggregate results are the state-level impacts of the MILC program alternatives shown in Table 3. The option that is most attractive to a particular state depends entirely on that state's herd size. Small herd states prefer a MILC option that caps direct payments while large-herd states like the option that does not have a production cap on direct payments or the option of no direct payments. The first section of Table 3 presents the level of revenue for the baseline (the all milk price in the state plus any direct payment averaged across all milk marketed in the state). The remaining three sections of Table 3 provide the change in net revenue relative to the baseline. In 2012, California net revenue is highest under the MILC+ scenario and lowest under the MILC scenario while Wisconsin revenue is highest under the MILC scenario and lowest under the baseline.

The regional effect of these MILC scenarios is further illustrated in Figures 1 and 2. These graphics provide the short (2003-2007) and long (2008-2012) run effect of each MILC program scenario on Wisconsin, California, and U.S. net revenue. It is clear that California enjoys the highest revenue under the MILC+ scenario in both the short and long run. Even in the long run, however, the higher direct payments are being eroded away by lower milk prices. In the short run, Wisconsin is only slightly better off under the MILC scenario relative to the MILC+ scenario but is clearly better off in the long run under the MILC scenario relative to any of the other scenarios. At the U.S. level, the highest revenue in the short run is found in the MILC+ scenario. However, in the long run, the difference between scenarios is narrowing, although the MILC+ scenario is still showing the highest net revenue.

It is informative to note that even when the MILC program is extended to cover all milk, the market, as measured by all milk prices, is responsible for 90 percent of revenue while the MILC direct payment makes up the remaining 10 percent. The fact that the direct payment formula returns only 40 percent of the difference between $16.94 per cwt. and the Boston class I price keeps the amount of revenue provided by the government at a much lower level than if the full difference was paid.

Table 3. The Regional Impacts on Revenue of Alternative MILC Program Options

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
							($/cwt.)					
Baseline (Revenue Level)												
California	11.09	11.13	11.17	11.24	11.30	11.44	11.47	11.55	11.65	11.73	11.19	11.57
Wisconsin	13.45	13.50	13.52	12.80	12.88	13.02	13.06	13.16	13.28	13.38	13.23	13.18
New York	13.80	13.83	13.86	13.23	13.31	13.45	13.49	13.58	13.69	13.78	13.61	13.60
Pennsylvania	14.89	14.92	14.94	14.17	14.24	14.39	14.42	14.51	14.62	14.72	14.63	14.53
Minnesota	13.52	13.57	13.60	12.87	12.95	13.10	13.14	13.23	13.35	13.46	13.30	13.25
Idaho	11.74	11.79	11.83	11.82	11.90	12.04	12.08	12.17	12.28	12.38	11.82	12.19
New Mexico	11.92	11.99	12.03	12.21	12.29	12.43	12.47	12.56	12.68	12.78	12.09	12.59
Michigan	13.13	13.18	13.21	12.66	12.73	12.88	12.91	13.01	13.12	13.22	12.98	13.03
Washington	12.48	12.53	12.56	12.50	12.57	12.72	12.74	12.83	12.94	13.03	12.53	12.85
Texas	13.45	13.50	13.54	13.26	13.34	13.48	13.52	13.61	13.72	13.82	13.42	13.63
Other States	13.45	13.50	13.52	12.98	13.06	13.20	13.24	13.33	13.44	13.54	13.30	13.35
MILC (Δ in Revenue relative to Baseline)												
California	0.00	0.00	0.00	-0.05	-0.17	-0.24	-0.28	-0.32	-0.33	-0.34	-0.04	-0.30
Wisconsin	0.00	0.00	0.00	0.74	0.63	0.54	0.49	0.44	0.39	0.35	0.27	0.44
New York	0.00	0.00	0.00	0.64	0.53	0.43	0.39	0.34	0.29	0.25	0.23	0.34
Pennsylvania	0.00	0.00	0.00	0.79	0.68	0.58	0.53	0.48	0.42	0.38	0.29	0.48
Minnesota	0.00	0.00	0.00	0.74	0.63	0.54	0.49	0.44	0.39	0.35	0.27	0.44
Idaho	0.00	0.00	0.00	0.02	-0.09	-0.17	-0.21	-0.25	-0.27	-0.28	-0.01	-0.24
New Mexico	0.00	0.00	0.00	-0.16	-0.28	-0.35	-0.39	-0.42	-0.43	-0.43	-0.09	-0.40
Michigan	0.00	0.00	0.00	0.56	0.45	0.36	0.32	0.27	0.22	0.19	0.20	0.27
Washington	0.00	0.00	0.00	0.08	-0.04	-0.12	-0.17	-0.21	-0.23	-0.24	0.01	-0.19
Texas	0.00	0.00	0.00	0.29	0.18	0.10	0.05	0.01	-0.02	-0.04	0.10	0.02
Other States	0.00	0.00	0.00	0.56	0.45	0.35	0.31	0.26	0.22	0.18	0.20	0.26
MILC+ (Δ in Revenue relative to Baseline)												
California	0.89	0.79	0.74	0.64	0.52	0.41	0.35	0.29	0.23	0.19	0.72	0.30
Wisconsin	0.06	-0.01	-0.05	0.65	0.53	0.41	0.36	0.30	0.24	0.20	0.24	0.30
New York	0.14	0.06	0.02	0.62	0.50	0.38	0.32	0.26	0.20	0.16	0.27	0.26
Pennsylvania	-0.01	-0.08	-0.13	0.62	0.50	0.38	0.32	0.26	0.20	0.16	0.18	0.27
Minnesota	0.06	-0.01	-0.05	0.66	0.53	0.42	0.37	0.30	0.25	0.20	0.24	0.31
Idaho	0.79	0.70	0.64	0.63	0.50	0.38	0.33	0.26	0.21	0.16	0.65	0.27
New Mexico	1.00	0.90	0.84	0.64	0.51	0.40	0.34	0.28	0.22	0.18	0.78	0.29
Michigan	0.23	0.16	0.11	0.64	0.51	0.40	0.34	0.28	0.22	0.18	0.33	0.28
Washington	0.72	0.62	0.57	0.60	0.47	0.35	0.29	0.23	0.17	0.13	0.60	0.23
Texas	0.52	0.43	0.38	0.64	0.51	0.40	0.34	0.28	0.22	0.18	0.50	0.28
Other States	0.24	0.16	0.11	0.63	0.51	0.39	0.34	0.27	0.22	0.17	0.33	0.28
No MILC (Δ in Revenue relative to Baseline)												
California	0.05	0.17	0.24	0.23	0.15	0.10	0.07	0.05	0.03	0.02	0.17	0.05
Wisconsin	-0.78	-0.64	-0.55	0.23	0.15	0.10	0.07	0.05	0.03	0.02	-0.32	0.05
New York	-0.68	-0.53	-0.45	0.24	0.15	0.10	0.07	0.05	0.03	0.02	-0.25	0.06
Pennsylvania	-0.84	-0.69	-0.60	0.24	0.15	0.10	0.07	0.05	0.03	0.02	-0.35	0.06
Minnesota	-0.78	-0.64	-0.55	0.23	0.15	0.10	0.07	0.05	0.03	0.02	-0.32	0.05
Idaho	-0.03	0.10	0.17	0.24	0.15	0.10	0.07	0.05	0.03	0.02	0.13	0.06
New Mexico	0.16	0.28	0.35	0.24	0.15	0.10	0.07	0.05	0.03	0.02	0.24	0.05
Michigan	-0.60	-0.46	-0.38	0.24	0.15	0.10	0.07	0.05	0.03	0.02	-0.21	0.05
Washington	-0.08	0.04	0.12	0.25	0.16	0.11	0.07	0.05	0.03	0.03	0.10	0.06
Texas	-0.32	-0.18	-0.10	0.24	0.15	0.10	0.07	0.05	0.03	0.02	-0.04	0.05
Other States	-0.59	-0.45	-0.37	0.24	0.15	0.10	0.07	0.05	0.03	.0.02	-0.20	0.06

Baseline - FAPRI March 2003 Baseline, **MILC** - Extend current MILC program through 2012, **MILC+** - Extend MILC program through 2012 and pay on all milk marketed, **No MILC** - Eliminate the current MILC program 1/1/2003

Figure 1. Revenue Effects of the MILC Program, 2003-2007 Average

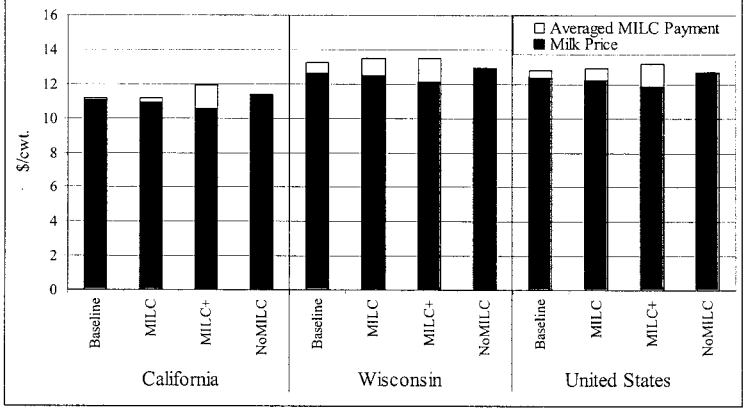
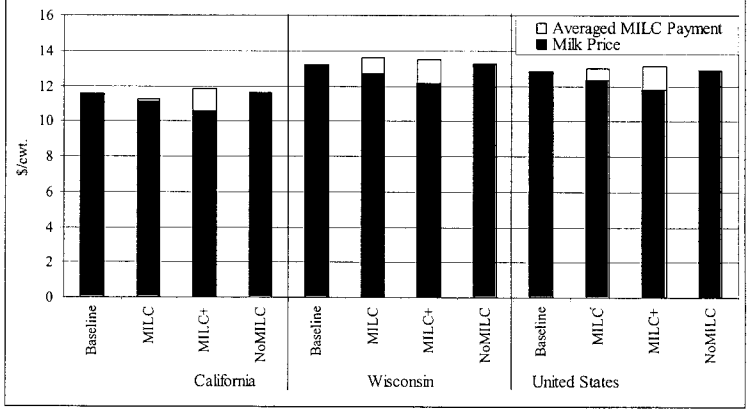


Figure 2. Revenue Effects of the MILC Program, 2008-2012 Average



Price Support Program and DEIP Elimination

This section will explore the effects on the dairy sector of eliminating the price support program and the DEIP. These alternatives are compared to the NoMILC scenario as this research continues to peal away each layer of federal dairy policy. The yardstick against which these scenarios are compared is important. The outlook for the dairy sector suggests that nonfat dry milk will continue to be in surplus for several years yet the government does not accumulate any stocks of other dairy products. If demand for nonfat solids would be larger than shown here or demand for butterfat weaker, this analysis would show different effects as these programs are eliminated. Similarly, the baseline assumes full use of the DEIP for nonfat dry milk, but no use in cheese or butter.

Two assumptions dealing with the world price outlook for butter and nonfat dry milk are needed to look at the scenarios in this section. World nonfat dry milk prices are assumed to be the average of the 1990 to 2000 level less $0.10 per lb. for transportation. That puts a floor on U.S. nonfat dry milk prices of $0.68 per lb. Likewise, world butter prices are assumed to equal their 1990 to 2000 average. Once the tariff is added to the world butter price, it suggests that additional butter imports would enter the United States once the U.S. butter price exceeds $1.50 per lb. These assumptions oversimplify the linkages and dynamics that exist in global dairy markets.

One final assumption is needed concerning the release of large quantities of nonfat dry milk stocks held by the government. This analysis assumes that in 2003 and 2004 300 million pounds of nonfat dry milk held by the government is eliminated with no market effect. The remaining government-held inventory is assumed to enter the market equally in 2003 and 2004. This is one of numerous ways the government could dispose of nonfat dry milk in storage.

The outcome of these scenarios is summarized in Table 4. Both of these scenarios have the largest impact on nonfat dry milk markets. Table 4 provides the level results for the NoMILC, NoMILC/CCC, and NoMILC/CCC/DEIP. The comparison to the NoMILC scenario is used so that the impact of eliminating the support price program and DEIP can be isolated. The NoMILC/CCC scenario ends the price support program at the beginning of 2003 while the NoMILC/CCC/DEIP eliminates the price support program and the DEIP at the start of 2003.

Under the NoMILC/CCC scenario, the first two years of the scenario show the largest changes as the government gets out of the stock-holding business. Although this research assumes that 300 million pounds of nonfat dry milk held by the government never reaches commercial markets in the first two years of the analysis, the government could choose to not let any nonfat dry milk held in government inventory reach commercial markets and that would minimize the effect of eliminating the price support program. An additional 700 million pounds of nonfat dry milk enters the market in 2003 under the NoMILC/CCC scenario. Domestic nonfat dry milk prices fall to world prices and the United States is able to commercially export 193 million pounds of nonfat dry milk. Nonfat dry milk production declines by 223 million pounds, leaving the balance of the additional nonfat dry milk to be domestically consumed.

A similar story can be told for the 2004 results. After 2004, all government inventory of nonfat dry milk is gone. That leaves a much smaller amount of nonfat dry milk that must enter domestic markets. For example, in 2008 an additional 106 million pounds of nonfat dry milk

that was removed under the NoMILC scenario now ends up in commercial channels, 14% compared to the 2003 level.

The NoMILC/CCC/DEIP scenario shows similar directional results, only larger magnitudes. In the first two years of the analysis, eliminating the DEIP only causes switching of DEIP product to commercial exports. However, the NoMILC/CCC/DEIP scenario keeps nonfat dry milk prices lower in the out-years of the analysis since domestic prices are too high to allow the formerly subsidized product to move as commercially exported product.

As less milk is produced under both of the scenarios relative to the NoMILC scenario, less fat is available to churn into butter. That causes butter prices to rise to the point that additional imports enter the U.S. In 2004 under the NoMILC/CCC/DEIP scenario, an additional 75 million pounds of butter enters the U.S.

Cheese markets experience an increase in production in the early years of both scenarios as milk supplies are diverted away from nonfat dry milk and butter markets. Cheese prices are $0.05 per pound lower than the NoMILC scenario during the first two years. Once milk supplies adjust, cheese prices approach the NoMILC levels.

All milk prices are $0.40 to $0.45 per cwt lower the first two years under both scenarios. However, beginning in 2005 all milk prices return to the baseline in the NoCCC scenario as they are propped up by higher butter prices. Under the NoCCC/DEIP scenario all milk prices remain below the NoMILC scenario as nonfat dry milk and cheese prices remain below the NoMILC scenario. Milk supplies adjust down under both of these scenarios. In 2012 under the NoCCC/DEIP scenario, milk production is 1.2 billion pounds less than under the NoMILC scenario.

Table 4. Impact of the Elimination of the Price Support Program and the DEIP on the U.S. Dairy Sector

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
Nonfat Dry Milk Net Removals (mil. lbs.)												
NoMILC	418	314	280	259	244	251	239	220	200	183	303	219
NoMILC/CCC	-285	-485	145	145	145	145	145	145	145	145	-67	145
NoMILC/CCC/DEIP	-430	-630	0	0	0	0	0	0	0	0	-212	0
Nonfat Dry Milk Production (mil. lbs.)												
NoMILC	1,433	1,364	1,348	1,341	1,339	1,362	1,362	1,359	1,357	1,357	1,365	1,359
NoMILC/CCC	1,210	1,106	1,287	1,292	1,301	1,321	1,330	1,340	1,350	1,360	1,239	1,340
NoMILC/CCC/DEIP	1,210	1,106	1,167	1,170	1,177	1,193	1,206	1,215	1,225	1,236	1,166	1,215
Nonfat Dry Milk Commerical Exports (mil. lbs.)												
NoMILC	-	-	-	-	-	-	-	-	-	-	-	-
NoMILC/CCC	193	264	-	-	-	-	-	-	-	-	91	-
NoMILC/CCC/DEIP	338	409	-	-	-	-	-	-	-	-	149	-
Butter Production (mil. lbs.)												
NoMILC	1,314	1,292	1,292	1,293	1,292	1,306	1,306	1,306	1,305	1,304	1,297	1,305
NoMILC/CCC	1,241	1,195	1,274	1,277	1,281	1,293	1,297	1,300	1,302	1,305	1,253	1,299
NoMILC/CCC/DEIP	1,241	1,195	1,224	1,226	1,228	1,238	1,244	1,246	1,249	1,251	1,222	1,245
Butter Imports (mil. lbs.)												
NoMILC	32	32	32	32	34	36	38	40	42	44	32	40
NoMILC/CCC	75	32	64	107	37	32	34	36	38	40	63	36
NoMILC/CCC/DEIP	64	107	82	82	84	90	86	88	90	92	84	89
Cheese Production (mil. lbs.)												
NoMILC	8,397	8,576	8,719	8,876	9,039	9,190	9,357	9,522	9,688	9,855	8,721	9,522
NoMILC/CCC	8,489	8,656	8,697	8,869	9,034	9,191	9,358	9,520	9,684	9,849	8,749	9,520
NoMILC/CCC/DEIP	8,489	8,656	8,748	8,902	9,061	9,215	9,376	9,538	9,700	9,865	8,771	9,539
Nonfat Dry Milk Price ($/lb.)												
NoMILC	0.84	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.82	0.81
NoMILC/CCC	0.68	0.68	0.78	0.78	0.79	0.78	0.79	0.80	0.81	0.82	0.74	0.80
NoMILC/CCC/DEIP	0.68	0.68	0.73	0.74	0.75	0.75	0.75	0.76	0.77	0.78	0.71	0.76
Butter Price ($/lb.)												
NoMILC	1.27	1.36	1.39	1.40	1.39	1.42	1.41	1.42	1.43	1.44	1.36	1.42
NoMILC/CCC	1.51	1.53	1.50	1.50	1.47	1.49	1.47	1.46	1.45	1.44	1.50	1.46
NoMILC/CCC/DEIP	1.51	1.53	1.53	1.53	1.51	1.53	1.52	1.51	1.50	1.49	1.52	1.51
Cheese Price ($/lb.)												
NoMILC	1.27	1.28	1.29	1.30	1.30	1.31	1.31	1.32	1.33	1.34	1.29	1.32
NoMILC/CCC	1.22	1.23	1.30	1.31	1.30	1.31	1.31	1.32	1.33	1.34	1.27	1.32
NoMILC/CCC/DEIP	1.22	1.23	1.27	1.28	1.29	1.29	1.30	1.31	1.32	1.33	1.26	1.31
Class III Price ($/cwt.)												
NoMILC	11.23	11.42	11.53	11.59	11.59	11.69	11.70	11.78	11.89	11.99	11.47	11.81
NoMILC/CCC	10.82	10.97	11.64	11.70	11.66	11.72	11.72	11.81	11.92	12.02	11.36	11.84
NoMILC/CCC/DEIP	10.82	10.97	11.37	11.48	11.50	11.58	11.63	11.72	11.84	11.95	11.23	11.74
Class IV Price ($/cwt.)												
NoMILC	10.81	10.95	11.08	11.13	11.09	11.18	11.15	11.18	11.24	11.28	11.01	11.21
NoMILC/CCC	10.40	10.49	11.28	11.28	11.20	11.24	11.20	11.23	11.29	11.33	10.93	11.26
NoMILC/CCC/DEIP	10.40	10.49	10.95	11.03	11.02	11.09	11.10	11.14	11.21	11.26	10.78	11.16
All Milk Price ($/cwt.)												
NoMILC	12.45	12.61	12.71	12.75	12.73	12.81	12.80	12.86	12.95	13.02	12.65	12.89
NoMILC/CCC	12.04	12.15	12.83	12.86	12.80	12.84	12.83	12.89	12.98	13.06	12.54	12.92
NoMILC/CCC/DEIP	12.04	12.15	12.55	12.64	12.64	12.70	12.73	12.80	12.90	12.98	12.40	12.82
Milk Production (bil. lbs.)												
NoMILC	170.3	171.7	173.1	174.7	176.3	178.1	179.8	181.6	183.4	185.2	173.2	181.6
NoMILC/CCC	169.5	170.3	172.4	174.2	175.9	177.8	179.6	181.4	183.2	185.1	172.4	181.4
NoMILC/CCC/DEIP	169.5	170.3	171.8	173.4	175.0	176.7	178.5	180.3	182.1	184.0	172.0	180.3

NoMILC - Eliminate the current MILC program 1/1/2003, **NoMILC/CCC** - Eliminate the price support program 1/1/2003 in addtion to MILC elimination, **NoMILC/CCC/DEIP** - Eliminate the price support program and the DEIP 1/1/2003 in addtion to MILC elimination

Federal Order Elimination

Elimination of the federal order system is a difficult task for the FAPRI dairy model or for that matter any model that is formed with data that has embedded in it the presence of the federal order system. Some of the particulars of federal order elimination are likely lost in this quantitative assessment. Hopefully, these results provide the directional impact of eliminating the federal order system.

Many assumptions were necessary to conduct this portion of the analysis. The first assumption deals with the pricing of milk used for purposes other than fluid consumption. The analysis assumes that Class II, III, and IV milk prices are gone and one market-clearing price replaces them. The alternatives that could replace the classified minimum prices are endless. This analysis assumes that the manufacturing price will be the average of the Class III and IV price formulas. This price will be used for all manufacturing uses.

This analysis looked at two alternatives for fluid milk prices under elimination of federal orders. The first scenario, NoMILC/CCC/DEIP/FMMO, assumes that fluid premiums will exist without orders and average, nationally, $0.50 per cwt. over the manufacturing price. These premiums are not the same across states but follow a pattern similar to current Class I differentials although the surface is much flatter. The second scenario, NoMILC/CCC/DEIP/FMMO©, assumes there would be no fluid premiums in the absence of federal orders.

These scenarios are run assuming that California makes no changes to its state milk system. It is reasonable to question whether the California system could remain intact with federal order elimination, but that effort is left to other rounds of policy analysis. This assumption helps lead to the results shown in Tables 5 and 6.

Table 5 shows that the largest negative price effects on milk occur in the first few years of the analysis. Once supply adjustment occurs, milk prices return closer to levels found before federal order elimination. Fluid consumption rises 2.5 percent as federal orders are eliminated.

Table 5. Summary of the Impact of Alternative Federal Milk Market Order Options on the U.S. Dairy Sector

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
Milk Cows (thou. head)												
NoMILC/CCC/DEIP	9,003	8,896	8,831	8,784	8,744	8,713	8,688	8,668	8,652	8,639	8,851	8,672
NoMILC/CCC/DEIP/FMMO	8,969	8,828	8,768	8,724	8,686	8,655	8,631	8,611	8,594	8,581	8,795	8,614
NoMILC/CCC/DEIP/FMMO©	8,953	8,797	8,743	8,700	8,665	8,636	8,612	8,593	8,576	8,563	8,772	8,596
Milk Production (bil. lbs.)												
NoMILC/CCC/DEIP	169.5	170.3	171.8	173.4	175.0	176.7	178.5	180.3	182.1	184.0	172.0	180.3
NoMILC/CCC/DEIP/FMMO	168.7	168.7	170.7	172.4	174.0	175.8	177.6	179.4	181.2	183.1	170.9	179.4
NoMILC/CCC/DEIP/FMMO©	168.3	168.1	170.4	172.0	173.7	175.5	177.4	179.2	181.1	182.9	170.5	179.2
All Milk Price ($/cwt.)												
NoMILC/CCC/DEIP	12.04	12.15	12.55	12.64	12.64	12.70	12.73	12.80	12.90	12.98	12.40	12.82
NoMILC/CCC/DEIP/FMMO	11.57	11.63	12.53	12.62	12.60	12.65	12.69	12.76	12.87	12.95	12.19	12.79
NoMILC/CCC/DEIP/FMMO©	11.35	11.42	12.59	12.62	12.63	12.67	12.70	12.77	12.88	12.97	12.12	12.80
Fluid Milk Consumption (lbs.)												
NoMILC/CCC/DEIP	208	208	207	206	205	204	204	203	203	203	207	203
NoMILC/CCC/DEIP/FMMO	211	212	209	209	208	207	206	206	205	205	210	206
NoMILC/CCC/DEIP/FMMO©	213	213	210	209	208	208	207	206	206	206	211	207

NoMILC/CCC/DEIP - Eliminate the MILC program, price support program and DEIP on 1/1/2003, **NoMILC/CCC/DEIP/FMMO** - In addition to the previous programs eliminated, eliminate FMMOs 1/1/2003, allow for fluid milk premiums, **NoMILC/CCC/DEIP/FMMO©** - Identical to NoFMMO except have zero fluid premiums

The result on the U.S. all milk price of these alternatives needs further discussion. The FAPRI model calculates the U.S. all milk price as a current production weighted average of the state-level all milk prices. The result of constructing the U.S. all milk price in this fashion is that if the production effect of policy changes on a low all milk price state like California is positive then the California all milk price will get a larger weight and that will have a negative effect on the U.S. all milk price. This result occurs in these scenarios.

Table 6 shows that the state-level results of these federal order elimination scenarios are not uniform across the country. It appears that states with less than 20 percent fluid utilization show higher all milk prices with the elimination of federal orders while those states with fluid utilization in excess of 35 percent clearly are better off with the federal order system in place. Again, it is important to note that no change was made to the California order system and that they are much better off under the elimination of federal orders because as dairy product prices increase all of their class prices adjust upward as well.

Table 6. The Regional Impact on Milk Prices of Alternative Federal Milk Market Order Options

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
						($/cwt.)						
NoMILC/CCC/DEIP (All Milk Price)												
California	10.71	10.83	11.24	11.34	11.35	11.42	11.45	11.53	11.63	11.71	11.09	11.55
Wisconsin	12.27	12.41	12.81	12.92	12.94	13.01	13.06	13.15	13.26	13.36	12.67	13.17
New York	12.71	12.85	13.26	13.36	13.37	13.45	13.49	13.57	13.68	13.77	13.11	13.59
Pennsylvania	13.64	13.78	14.19	14.30	14.31	14.38	14.42	14.50	14.61	14.70	14.04	14.53
Minnesota	12.34	12.48	12.88	12.99	13.01	13.09	13.13	13.22	13.34	13.44	12.74	13.24
Idaho	11.30	11.44	11.85	11.95	11.97	12.04	12.08	12.16	12.27	12.36	11.70	12.18
New Mexico	11.68	11.82	12.23	12.34	12.35	12.43	12.47	12.56	12.67	12.76	12.09	12.58
Michigan	12.13	12.27	12.67	12.78	12.79	12.87	12.91	13.00	13.11	13.21	12.53	13.02
Washington	11.99	12.12	12.53	12.64	12.64	12.72	12.75	12.83	12.93	13.02	12.38	12.85
Texas	12.73	12.87	13.28	13.38	13.40	13.47	13.52	13.60	13.71	13.81	13.13	13.62
Other States	12.46	12.59	13.00	13.11	13.12	13.20	13.24	13.32	13.43	13.53	12.86	13.34
NoMILC/CCC/DEIP/FMMO (Δ in All Milk Price Relative to NoMILC/CCC/DEIP)												
California	0.23	0.19	0.66	0.66	0.65	0.64	0.65	0.66	0.68	0.69	0.48	0.67
Wisconsin	-0.32	-0.40	0.12	0.11	0.08	0.07	0.07	0.06	0.05	0.04	-0.08	0.05
New York	-1.03	-1.10	-0.60	-0.60	-0.62	-0.63	-0.63	-0.63	-0.63	-0.63	-0.79	-0.63
Pennsylvania	-1.01	-1.07	-0.57	-0.58	-0.59	-0.61	-0.61	-0.61	-0.61	-0.61	-0.76	-0.61
Minnesota	-0.27	-0.35	0.16	0.15	0.13	0.11	0.11	0.10	0.09	0.08	-0.03	0.10
Idaho	-0.17	-0.24	0.27	0.26	0.24	0.23	0.23	0.23	0.23	0.23	0.07	0.23
New Mexico	-1.02	-1.09	-0.58	-0.59	-0.61	-0.63	-0.62	-0.63	-0.63	-0.64	-0.78	-0.63
Michigan	-0.60	-0.68	-0.17	-0.17	-0.20	-0.21	-0.21	-0.22	-0.22	-0.23	-0.36	-0.22
Washington	-0.16	-0.22	0.27	0.27	0.26	0.24	0.25	0.26	0.26	0.27	0.08	0.26
Texas	-1.03	-1.10	-0.59	-0.60	-0.62	-0.64	-0.63	-0.64	-0.65	-0.65	-0.79	-0.64
Other States	-0.73	-0.80	-0.30	-0.30	-0.32	-0.34	-0.34	-0.34	-0.34	-0.35	-0.49	-0.34
NoMILC/CCC/DEIP/FMMO® (Δ in All Milk Price Relative to NoMILC/CCC/DEIP)												
California	0.26	0.23	0.97	0.91	0.92	0.90	0.90	0.91	0.92	0.93	0.66	0.91
Wisconsin	-0.45	-0.51	0.27	0.20	0.20	0.17	0.16	0.15	0.14	0.13	-0.06	0.15
New York	-1.38	-1.43	-0.66	-0.73	-0.72	-0.75	-0.75	-0.76	-0.76	-0.76	-0.98	-0.75
Pennsylvania	-1.35	-1.40	-0.63	-0.70	-0.69	-0.72	-0.72	-0.73	-0.73	-0.73	-0.96	-0.73
Minnesota	-0.38	-0.44	0.34	0.27	0.27	0.24	0.23	0.22	0.21	0.20	0.02	0.22
Idaho	-0.28	-0.33	0.44	0.37	0.38	0.35	0.35	0.34	0.34	0.33	0.12	0.34
New Mexico	-1.41	-1.46	-0.69	-0.76	-0.75	-0.78	-0.79	-0.80	-0.81	-0.81	-1.01	-0.80
Michigan	-0.83	-0.88	-0.11	-0.18	-0.17	-0.20	-0.21	-0.22	-0.22	-0.23	-0.43	-0.22
Washington	-0.30	-0.34	0.42	0.35	0.37	0.34	0.34	0.34	0.34	0.35	0.10	0.34
Texas	-1.52	-1.57	-0.80	-0.87	-0.86	-0.89	-0.90	-0.91	-0.91	-0.92	-1.12	-0.91
Other States	-1.16	-1.21	-0.44	-0.51	-0.50	-0.53	-0.54	-0.55	-0.55	-0.56	-0.77	-0.54

NoMILC/CCC/DEIP - Eliminate the MILC program, price support program and DEIP on 1/1/2003, **NoMILC/CCC/DEIP/FMMO** - In addition to the previous programs eliminated, eliminate FMMOs 1/1/2003, allow for fluid milk premiums, **NoMILC/CCC/DEIP/FMMO®** - Identical to NoFMMO except have zero fluid premiums

Table 7. Summary of the Effects of Removing Federal Dairy Policy on the U.S. Dairy Sector

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	03-07 Ave.	08-12 Ave.
Milk Production (bil. lbs.)	171.2	172.8	174.5	175.4	176.7	178.4	180.0	181.7	183.5	185.2	174.1	181.8
MILC	(0.0)	(0.0)	(0.0)	0.8	1.1	1.3	1.4	1.5	1.5	1.5	0.4	1.4
MILC+	0.8	1.1	1.3	2.3	2.7	2.9	3.1	3.2	3.2	3.1	1.6	3.1
NoMILC	(0.9)	(1.2)	(1.3)	(0.7)	(0.4)	(0.3)	(0.2)	(0.1)	(0.1)	(0.1)	(0.9)	(0.2)
NoMILC/CCC	(1.7)	(2.6)	(2.1)	(1.2)	(0.8)	(0.6)	(0.5)	(0.3)	(0.2)	(0.1)	(1.7)	(0.4)
NoMILC/CCC/DEIP	(1.7)	(2.6)	(2.7)	(2.0)	(1.8)	(1.7)	(1.5)	(1.4)	(1.3)	(1.2)	(2.1)	(1.4)
NoMILC/CCC/DEIP/FMMO	(2.5)	(4.1)	(3.8)	(3.0)	(2.7)	(2.6)	(2.4)	(2.3)	(2.2)	(2.1)	(3.2)	(2.3)
NoMILC/CCC/DEIP/FMMO®	(3.0)	(4.7)	(4.1)	(3.3)	(3.0)	(2.8)	(2.7)	(2.5)	(2.4)	(2.3)	(3.6)	(2.5)
All Milk Price ($/cwt.)	12.19	12.24	12.27	12.52	12.58	12.71	12.73	12.81	12.91	13.00	12.36	12.83
MILC	(0.00)	(0.00)	(0.00)	(0.24)	(0.36)	(0.43)	(0.47)	(0.50)	(0.50)	(0.50)	(0.12)	(0.48)
MILC+	(0.23)	(0.35)	(0.42)	(0.72)	(0.88)	(0.97)	(1.03)	(1.06)	(1.06)	(1.05)	(0.52)	(1.04)
NoMILC	0.25	0.37	0.44	0.23	0.15	0.10	0.07	0.04	0.03	0.02	0.29	0.05
NoMILC/CCC	(0.16)	(0.09)	0.56	0.34	0.22	0.13	0.09	0.08	0.07	0.06	0.18	0.09
NoMILC/CCC/DEIP	(0.16)	(0.09)	0.28	0.12	0.05	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	0.04	(0.01)
NoMILC/CCC/DEIP/FMMO	(0.62)	(0.61)	0.26	0.10	0.02	(0.06)	(0.04)	(0.05)	(0.05)	(0.05)	(0.17)	(0.05)
NoMILC/CCC/DEIP/FMMO®	(0.85)	(0.82)	0.32	0.10	0.05	(0.04)	(0.03)	(0.04)	(0.04)	(0.04)	(0.24)	(0.04)
MILC Payment ($/cwt.) a/	1.22	1.18	1.16	-	-	-	-	-	-	-	0.71	-
MILC	0.00	0.00	0.00	1.15	1.17	1.13	1.13	1.10	1.05	1.00	0.46	1.08
MILC+	0.10	0.15	0.18	1.35	1.39	1.36	1.37	1.34	1.29	1.23	0.63	1.32
NoMILC	(1.22)	(1.18)	(1.16)	-	-	-	-	-	-	-	(0.71)	-
NoMILC/CCC	(1.22)	(1.18)	(1.16)	-	-	-	-	-	-	-	(0.71)	-
NoMILC/CCC/DEIP	(1.22)	(1.18)	(1.16)	-	-	-	-	-	-	-	(0.71)	-
NoMILC/CCC/DEIP/FMMO	(1.22)	(1.18)	(1.16)	-	-	-	-	-	-	-	(0.71)	-
NoMILC/CCC/DEIP/FMMO®	(1.22)	(1.18)	(1.16)	-	-	-	-	-	-	-	(0.71)	-
Net Milk Revenue ($/cwt.) b/	12.91	12.93	12.95	12.52	12.58	12.71	12.73	12.81	12.91	13.00	12.78	12.83
MILC	(0.00)	(0.00)	(0.00)	0.43	0.32	0.23	0.19	0.15	0.11	0.08	0.15	0.15
MILC+	0.37	0.29	0.24	0.63	0.51	0.39	0.34	0.28	0.22	0.18	0.41	0.28
NoMILC	(0.46)	(0.32)	(0.24)	0.23	0.15	0.10	0.07	0.04	0.03	0.02	(0.13)	0.05
NoMILC/CCC	(1.38)	(1.27)	(0.60)	0.34	0.22	0.13	0.09	0.08	0.07	0.06	(0.54)	0.09
NoMILC/CCC/DEIP	(1.38)	(1.27)	(0.89)	0.12	0.05	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.67)	(0.01)
NoMILC/CCC/DEIP/FMMO	(1.84)	(1.79)	(0.91)	0.10	0.02	(0.06)	(0.04)	(0.05)	(0.05)	(0.05)	(0.88)	(0.05)
NoMILC/CCC/DEIP/FMMO®	(2.06)	(2.00)	(0.85)	0.10	0.05	(0.04)	(0.03)	(0.04)	(0.04)	(0.04)	(0.95)	(0.04)
Cheese Price ($/lb.)	1.25	1.25	1.26	1.28	1.29	1.30	1.30	1.31	1.33	1.34	1.27	1.32
MILC	(0.00)	(0.00)	(0.00)	(0.02)	(0.03)	(0.03)	(0.04)	(0.04)	(0.04)	(0.04)	(0.01)	(0.04)
MILC+	(0.02)	(0.03)	(0.03)	(0.06)	(0.07)	(0.08)	(0.08)	(0.09)	(0.09)	(0.09)	(0.04)	(0.08)
NoMILC	0.02	0.03	0.04	0.02	0.01	0.01	0.01	0.00	0.00	0.00	0.02	0.00
NoMILC/CCC	(0.03)	(0.02)	0.04	0.02	0.02	0.01	0.00	0.00	0.01	0.01	0.01	0.01
NoMILC/CCC/DEIP	(0.03)	(0.02)	0.01	0.00	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)
NoMILC/CCC/DEIP/FMMO	(0.01)	(0.00)	0.07	0.06	0.06	0.05	0.05	0.06	0.06	0.06	0.04	0.06
NoMILC/CCC/DEIP/FMMO®	(0.01)	(0.00)	0.10	0.09	0.08	0.07	0.08	0.08	0.08	0.08	0.05	0.08
Butter Price ($/lb.)	1.19	1.25	1.26	1.33	1.35	1.38	1.39	1.40	1.42	1.43	1.28	1.40
MILC	(0.00)	(0.00)	(0.00)	(0.07)	(0.11)	(0.13)	(0.14)	(0.15)	(0.15)	(0.15)	(0.04)	(0.14)
MILC+	(0.07)	(0.10)	(0.12)	(0.21)	(0.25)	(0.28)	(0.29)	(0.30)	(0.31)	(0.30)	(0.15)	(0.30)
NoMILC	0.08	0.11	0.13	0.07	0.05	0.03	0.02	0.02	0.01	0.01	0.09	0.02
NoMILC/CCC	0.32	0.28	0.24	0.17	0.12	0.11	0.09	0.06	0.03	0.00	0.22	0.06
NoMILC/CCC/DEIP	0.32	0.28	0.27	0.20	0.16	0.15	0.14	0.11	0.09	0.06	0.24	0.11
NoMILC/CCC/DEIP/FMMO	0.37	0.27	0.26	0.20	0.16	0.14	0.14	0.11	0.08	0.06	0.25	0.10
NoMILC/CCC/DEIP/FMMO®	0.38	0.32	0.30	0.21	0.20	0.17	0.17	0.14	0.12	0.09	0.28	0.14
Nonfat Dry Milk Price ($/lb.)	0.84	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.81	0.82	0.81
MILC	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
MILC+	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
NoMILC	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
NoMILC/CCC	(0.17)	(0.14)	(0.03)	(0.03)	(0.03)	(0.03)	(0.03)	(0.02)	(0.00)	- 0.01	(0.08)	(0.01)
NoMILC/CCC/DEIP	(0.17)	(0.14)	(0.09)	(0.08)	(0.07)	(0.07)	(0.06)	(0.05)	(0.04)	(0.03)	(0.11)	(0.05)
NoMILC/CCC/DEIP/FMMO	(0.16)	(0.11)	0.01	0.01	0.02	0.02	0.02	0.03	0.05	0.06	(0.05)	0.04
NoMILC/CCC/DEIP/FMMO®	(0.16)	(0.13)	0.03	0.03	0.04	0.03	0.04	0.05	0.06	0.08	(0.04)	0.05

Baseline - FAPRI March 2003 Baseline, **MILC** - Extend current MILC program through 2012, **MILC+** - Extend MILC program through 2012 and pay on all milk marketed, **No MILC** - Eliminate the current MILC program 1/1/2003, **NoMILC/CCC** - Eliminate the price support program 1/1/2003 in addtion to MILC elimination, **NoMILC/CCC/DEIP** - Eliminate the price support program and the DEIP 1/1/2003 in addtion to MILC elimination, **NoMILC/CCC/DEIP/FMMO** - In addition to the previous programs eliminated, eliminate FMMOs 1/1/2003, allow for fluid milk premiums, **NoMILC/CCC/DEIP/FMMO®** - Identical to NoMILC/CCC/DEIP/FMMO except have zero fluid premiums

a/ - Payment rate on eligible milk

b/ - Net revenue on all milk produced

Summary

The combined effect of eliminating all of the federal dairy policies examined in this paper results in less milk being produced in the United States. The short run disruption of eliminating features of dairy policy generally results in the largest decline in milk prices. Table 7 highlights that the longer run effect on milk prices or milk revenue in the case of a direct payment program is often less as milk supplies adjust to the changed policy. U.S. milk production declines by over 2 billion pounds in this analysis with the elimination of federal orders with no market generated fluid premiums, price support program, DEIP, and the MILC program.

This analysis highlights the reason regional battles have occurred as new dairy policy is debated. The impacts of eliminating the MILC program or the federal order system are not uniform across states. It appears from this analysis that the regional dairy battles that occur in the dairy policy debate are not over.

This analysis is meant to quantify the "corners" of dairy policy alternatives. It is an attempt to show how the industry would look under these different elimination scenarios. Each of these scenarios required assumptions to be made that can lead to particular results. A different set of assumptions could generate results that look quite different. The model used to judge these policy alternatives can be called into question when such large policy changes are made. The FAPRI model is always being examined to make changes to its structure to better deal with the kinds of questions that are being asked of it. These results are meant to help frame the dairy policy debate in quantitative terms.

STATEMENT OF KEITH COLLINS
CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE
BEFORE THE U.S. HOUSE COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON DEPARTMENT OPERATIONS, OVERSIGHT,
NUTRITION AND FORESTRY

May 20, 2003

Mr. Chairman and Members of the Subcommittee, thank you for the invitation to this hearing to provide information on the economic situation in the U.S. dairy industry. We all know that the market for milk has been very variable in recent years, with milk prices rising to high levels two to three years ago and then dropping to 25-year lows at the present time. I will provide our current assessment of the market situation for milk and dairy products, describe the recent production trends and assess the role of government programs in providing assistance to the nation's milk producers.

Milk Production Increases Slowing but Still Strong

The current dairy situation has strong ties to the 1996-2001 period when returns for dairy producers were fairly strong. The returns of that period provided incentives to expand production. However, those incentives were not realized during 2001 when poor weather adversely affected forage supplies and production per cow, and U.S. milk production declined 1.2 percent to 165.5 billion pounds. That was the largest annual drop since 1984, when the Federal government paid producers to reduce milk production. The production drop triggered a 21-percent increase in the all-milk price to $15.04 per cwt, the second highest ever.

In 2002, milk production resumed its upward path, increasing 2.6 percent to 169.8 billion pounds. Milk production grew at twice the rate of the previous 10 years, as producers responded to increased milk prices in 2001, and weather conditions helped improve forage and animal productivity. Milk cow numbers grew during most of 2002, going from below year earlier levels

at the start of the year to about 0.5 percent higher during the last quarter. In addition, milk output per cow rose 2.4 percent. The increase in output per cow, appearing large, represents only a 2 percent gain between 2000 and 2002, probably restrained by 2002's variable forage supplies, the lower milk prices caused by the milk production increase, and higher costs for feed.

On May 12, the Department of Agriculture (USDA) released new forecasts of milk production and use for the 2002/2003 marketing year that began October 1, 2002, and the first projections for 2003/2004. The figures show 2002/03 milk production slowing to a 1 percent increase to 170.9 billion pounds, and 2003/04 production up 1 percent to 172.6 billion pounds.

Dairy cows in 2002/03 are expected to average 9.13 million head, unchanged from 2001/02. Cow numbers are expected to begin declining year over year, starting with the second quarter of 2003. During 2003/04, cow numbers are then expected to decline about 1.5 percent to just below 9 million head. The decline in cow numbers is expected to result from low returns to producers, which is slowing expansion, and from more producers exiting from dairying. Up to now, the higher returns from earlier years plus the payments from the Milk Income Loss Contract (MILC) Program have likely led producers, especially those with smaller herds, to limit cow liquidations and farm exits.

Early in 2002, with milk prices just surpassing $15 per cwt, producers were encouraged to expand herds. At that time, replacement heifer supplies were tight and prices were being bid up. In April 2002, the average price for dairy replacement heifers was $1,710 per head, and the tight supplies probably restrained the increase in the nation's dairy herd that occurred.

For 2003, the average price of replacement heifers in April was $1,300 per head, a 24-percent drop from a year ago. The rise and then the drop in replacement heifer prices

suggests many heifers have been added to herds and that the incentive to add more has slowed. In addition, dairy cow slaughter is 15 percent above a year earlier through April of this year, reflecting the poorer returns and large numbers of dairy replacement heifers available. Producers are culling their poorer cows, and replacing them with more productive heifers. The increasing slaughter suggests cow numbers will decline this year, and milk per cow increases may be restrained as there will be more first-calf heifers in the herd. However, the added replacements could bolster milk output per cow in 2004.

With low milk-feed price ratios, erratic forage quality in 2002, and sizeable heifer replacement, milk per cow in 2002/03 is forecast to rise just 1 percent over the previous year. Milk per cow in 2003/04 is expected to grow about 3 percent despite continued low milk-feed price ratios.

Production Trends Continue–Western Expansion and Larger Operations

Milk production continues to shift by region and farm size. The number of dairy operations in the United States has been declining, most noticeably among small operations. For example, while the total number of milk cow operations declined 21 percent between 1998 and 2002, the number of operations with fewer than 200 head declined 23 percent, while operations with 500 head or more head increased 20 percent. As a result, in 2002, operations with 500 head or more were responsible for 37 percent of the U.S. dairy cow inventory and almost 42 percent of milk production, compared with 27 percent and 30 percent, respectively, 5 years ago.

Geographically, milk production has been shifting to the West, although there has been some expansion in some Midwestern states with the arrival of large dairy operations. In 1998, 3 western states, California, the nation's largest producer, Idaho and Washington, were in the top

10 producing states and responsible for almost 25 percent of U.S. milk production. By 2002, these 3 states produced almost 29 percent of U.S. milk, and New Mexico had joined the ranks of the top 10 producing states. Wisconsin, Minnesota, and Michigan have remained in the top 10 but their share of milk production declined from 24 percent in 1998 to 21 percent in 2002. In addition, Ohio has fallen from the list of top 10 producing states since 1998. In the East, New York and Pennsylvania have retained their ranks as the third and fourth largest producers, but their share of national production has fallen slightly.

Commercial Use Weak, Stocks Building

After notable increases in the late 1990s, commercial use of milk weakened in late 2001 and continued to be sluggish in 2002. Measured on a milk fat basis, use increased less than 1 percent during the 2001/02 marketing year compared with the prior year. Sales were slow despite the surge in milk production and declining wholesale prices. Retail prices also dropped below year-earlier levels during the second half of 2002. The U.S. economic slowdown, rising unemployment and consumer spending patterns all adversely affected food service sales. Sales of cheese, butter and fluid cream, particularly pizza cheese, were all weak.

Sales of butter and American cheese rose only 1 percent in 2002. Sales of other cheeses posted a much stronger increase of nearly 4 percent. Faced with increased competition from imported milk proteins and little apparent change in food processing formulations despite low prices, commercial use of nonfat dry milk fell more than a fifth. Sales of fluid milk and ice cream rose slightly.

As milk production bounced back in 2002, production of manufactured dairy products rose. Total cheese production was up 4 percent, butter production rose 10 percent, and nonfat

dry milk production increased 7 percent. The increases in cheese and butter production, in the face of weak demand, has led to sharp increases in inventory. At the start of the 2002/03 marketing year, butter stocks were 89 percent above a year earlier, and cheese stocks were 6 percent higher. Commercial stocks of all products on a milkfat basis were record high in early 2003. Meanwhile, the Commodity Credit Corporation (CCC) continued to accumulate nonfat dry milk stocks in government inventory.

Growth in dairy product demand is expected to improve in 2003. The U.S. economy is expected to strengthen as the year unfolds, and unemployment may begin to decline. These developments should help food service and grocery store sales. However, the demand growth probably will not be enough to meet the increase in milk production, reduce the large stocks and boost prices appreciably. Demand for fluid milk and soft products probably will continue flat, as sales of these products appear to be little affected by prices or the state of the U.S. economy.

For the 2002/03 marketing year, USDA estimates that commercial use of milk will rise 1.5 percent, slightly above the increase in production. Commercial use of dairy products in 2003/04 is expected to rise about 2.5 percent as low prices and a healthier economy stimulate sales, especially in restaurant and food processing markets.

Rising Production, Large Stocks, Weak Use Mean Lower Prices

Wholesale prices for manufactured products began to decline in 2001/02, as commercial use languished at less than 1 percent above the previous year and skim-solids use declined fractionally. On the Chicago Mercantile Exchange, the average cheese price fell from $1.36 per pound in 2000/01 to $1.24 in 2001/02 and butter declined from $1.63 per pound to $1.17. The price of nonfat dry milk (from the National Agricultural Statistics Service) declined from $1.00 per pound to $0.91, as USDA reduced the purchase price of nonfat dry milk and raised the

purchase price of butter to slow the accumulation of nonfat dry milk stocks. With product prices declining, the all-milk price fell to $12.74 per cwt in 2001/02, 12 percent below the 2000/01 level of $14.51 per cwt.

The price situation for this marketing year has been weaker, as milk production has increased, use remained weak and stocks of manufactured products reached a record high. Cheese prices are forecast to average $1.12 per pound, butter $1.07 per pound, and nonfat dry milk $0.83 per pound. The all-milk price is forecast to average $11.30 per cwt in 2002/03 with some seasonal increase as the summer progresses.

With cow numbers beginning to decline, modest increases in productivity expected, a stronger economy predicted by fall and improving commercial use, prices for cheese and butter in 2003/04 are projected to rise. However, given the weak demand and the sizeable imbalances in the market, price increases will likely be gradual. The all-milk price for 2003/04 is projected in a range of $11.05–12.05 per cwt.

International Markets Tightening

International dairy markets have tightened because of smaller supplies from Oceania at the end of their production season. New Zealand and Australia have had dry conditions and weak milk production at the start of 2003, leaving them with below-normal supplies of products to ship in coming months. With tighter supplies, international prices of nonfat dry milk rose to near the level of U.S. domestic prices during the last quarter of 2002. The European Union (EU) recently boosted their subsidy rate to offset the strength of the euro. During 2002/03 and 2003/04, international nonfat dry milk prices will probably be about 15-20 percent higher than during 2001/02, when prices were nearly $1,400 per metric ton or about 63 cents per pound.

International butter markets have been fairly weak and probably will stay so. Increased import demand from Russia caused some price increases last autumn but that has since dissipated. Uncertainties in the Middle East have hurt demand in that region.

In 2001/02, the United States exported about 4 million pounds of cheese and 164 million pounds of nonfat dry milk under the Dairy Export Incentive Program (DEIP). In addition to cheese and nonfat dry milk, the United States is exporting butter under DEIP in 2002/03. Export sales under DEIP have reached the World Trade Organization (WTO) limits of 68,201 metric tons for nonfat dry milk and 3,030 metric tons for cheese. Thus far, 5,000 tons of the WTO limit of 21,097 tons for butter have been approved for export under DEIP.

U.S. dairy imports in 2001/02 declined about 3 percent on a milkfat basis. U.S. prices weakened more than international prices, reducing high-tariff imports. Imports are expected to decline 2-4 percent in 2002/03 and 2003/04.

MPC Imports Stabilizing

Perhaps the most attention-grabbing trade issue for dairy is imports of milk protein concentrates (MPC) and their implication for U.S. prices. U.S. imports of milk protein concentrate, classification number 0404.90.10 of the Harmonized Tariff Schedule, grew from 805 metric tons in 1990, to 7,288 metric tons in 1995, and peaked at 52,928 metric tons in 2000. Milk protein concentrate imports declined to 28,469 metric tons in 2001, as the world market for dairy products tightened. In 2002, U.S. imports of MPC were 35,000 metric tons. Thus far in 2003, imports have been averaging about 3,000 metric tons per month, equivalent to a 36,000-ton annual rate, similar to 2002 and well below the peak year of 2000.

MPC ranges from 40 to 90 percent protein and 1 metric ton equals 2,204 pounds. Using that range, the amount of milk protein imported in the form of MPC is estimated at 31-69 million pounds in 2002. A pound of nonfat dry milk is about 33 percent protein, so MPC imports were equivalent to 94-210 million pounds of nonfat dry milk, on a protein basis, and equal to 0.6-1.4 percent of the U.S. production of milk protein in 2002. USDA purchased about 684 million pounds of nonfat dry milk under the milk price support program in 2002, far more than the volume of nonfat dry milk imported in the form MPC. MPC imports, to the extent that they replaced the protein from nonfat dry milk in commercial products, caused CCC purchases of nonfat dry milk to be higher than they would have been in the absence of the imports. However, CCC purchases still would have been considerable.

USDA Programs Make Substantial Contributions to Support the Dairy Farm Economy

Over the past year, USDA has announced several actions to help bring balance to dairy markets and help stabilize the incomes of dairy producers. Specifically, USDA announced actions affecting imports of American-type cheese, the Milk Price Support Program, the use of surplus nonfat dry milk (NDM) for humanitarian foreign assistance, the Dairy Export Incentive Program (DEIP) as described above, the Milk Income Loss Contract (MILC) program, and the Livestock Compensation Program (LCP).

In mid-November 2002, USDA announced that it was applying the volume-based WTO safeguard duty to above-quota imports of American-type cheese. Under the Uruguay Round Agreement on Agriculture, the United States is entitled to apply an additional duty on imports of American-type cheese when imports exceed a specified trigger. Imports of American-type

cheese exceeded the trigger level and the duty was raised by $0.16 per pound to its maximum permissible level of $0.64 per pound.

The Farm Security and Rural Investment Act of 2002 extended the Milk Price Support Program and authorized a new payment program for dairy producers, the MILC program. The MILC program is retroactive to December 2001 and is authorized through September 30, 2005. Under the MILC program, dairy operations are eligible to receive direct payments on up to 2.4 million pounds of milk production (about 135 cows) each fiscal year. The payment rate under the MILC program equals $16.94 less the Class I milk price in Boston times 0.45.

In 2002, the average payment rate under the MILC program was $1.21 per cwt. Payments as of May 9, 2003 had reached nearly $1.4 billion. Payments are expected to reach $2.4 billion by the end of this fiscal year. These payments offset about 40 percent of the 2002 decline in milk prices from 2001 for producers producing less than 2.4 million pounds and offset, on average, about 25 percent of the decline in milk prices across all producers nationwide. For 2003, if the payment under the MILC program is added to the projected all-milk price, dairy producers producing less than 2.4 million pounds could receive over $12.85 per cwt. for their milk in 2003, which is only 6 percent below the ten-year average all-milk price.

The MILC Program has been providing a level of support similar to that of the former Northeast Interstate Dairy Compact (the Compact). For New England producers producing less than 2.4 million pounds, the new MILC program provides greater compensation than the Compact. Over the period in which the Compact operated, July 1997 through September 2001, payments to producers averaged $16.94 minus the Class I price in Boston times 0.42, rather than

0.45 under the MILC program. Compared with the Compact, the MILC program increases the level of compensation to New England producers by about 7 percent.

Under the Milk Price Support Program, USDA supports the price of milk at the mandated level of $9.90 per cwt. by purchasing cheese, butter, and nonfat dry milk. USDA has purchased 10 million pounds of butter since purchases most recently began in January 2003, the first butter purchases since 1994. USDA has purchased 33 million pounds of cheese during 2002/03, compared with 5 million during all of 2001/02 and very little in the immediately preceding years. However, USDA has been purchasing large and growing amounts of nonfat dry milk. In 2001/02, USDA purchased 619 million pounds of nonfat dry milk, up from 418 million pounds purchased the year earlier. In 2002/03, purchases are forecast at 580 million pounds. At the end of FY 2001/02, USDA's inventory of nonfat dry milk reached 1.3 billion pounds, the largest stockpile since the mid-1980s and equivalent to nearly two years of commercial disappearance. The inventory currently stands at 1.245 billion pounds.

To help reduce inventory of nonfat dry milk, USDA has undertaken several initiatives. In August 2002, USDA implemented the Cattle Feed Program using nonfat dry milk as a protein source in supplemental feed to assist livestock operators in the states most severely stricken by drought. This program used about 250 million pounds of nonfat dry milk. In recent months, USDA has made nonfat dry milk held in storage available for domestic production of casein, which is not currently produced in the United States but imported in large quantities. USDA is also accepting proposals from U.S. private voluntary organizations and the World Food Program that will use nonfat dry milk for foreign humanitarian assistance. About 80,000 tons of nonfat dry milk are expected to be used for humanitarian assistance this year. USDA also initiated in

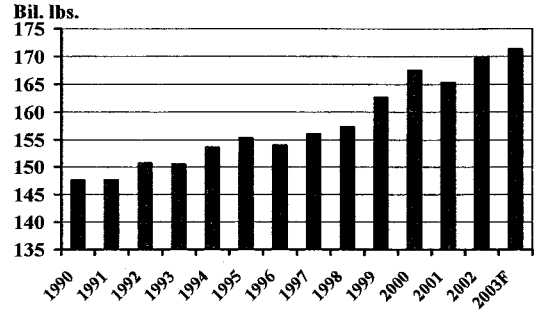
April 2003 a Livestock Feed Program to provide nonfat dry milk to livestock producers in 9 states most seriously affected by drought in 2003. Potentially up to 220 million pounds of nonfat dry milk are expected to be used in this program. Lastly, USDA reduced the purchase price of nonfat dry milk and raised the purchase price of butter to better balance the markets for these two products.

Despite the efforts to move nonfat dry milk through various channels in ways that do not disrupt traditional markets here or abroad, government stocks of nonfat dry milk remain at the their highest level since the mid-1980s. Fortunately, as a result of the distribution programs and the changes in purchase price levels, the price support program is now supporting milk prices through the purchase of all three manufactured products.

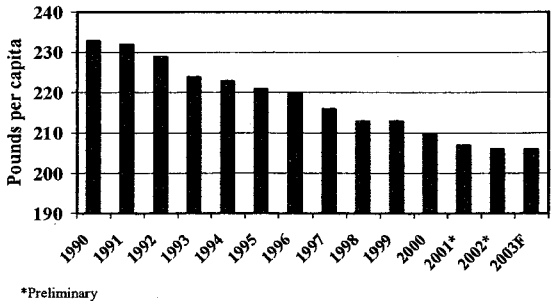
USDA has been very attentive to the situation in milk markets and has taken aggressive actions using our full range of authority provided by Congress. We have been mindful to the effect these actions have on commercial purchasers and taxpayers as well as producers. While farm-level milk prices are down sharply, programs administered through USDA will offset much of the drop in milk prices and producer incomes. While these actions will help provide near term financial assistance to dairy producers, they also risk extending the downturn in dairy prices, as producers may be encouraged to maintain or even increase production.

That completes my comments, Mr. Chairman and I would be pleased to respond to questions from you and the Members.

1--Milk Production Rises Sharply in 2002; Another Increase Expected in 2003

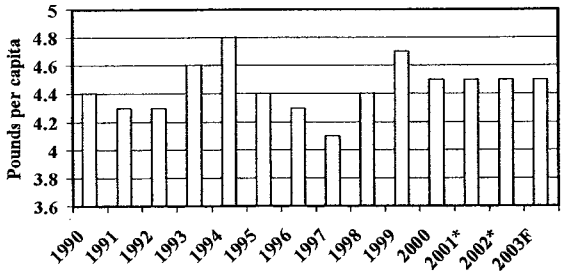


2--Per Capita Fluid Milk Consumption Continues Downtrend



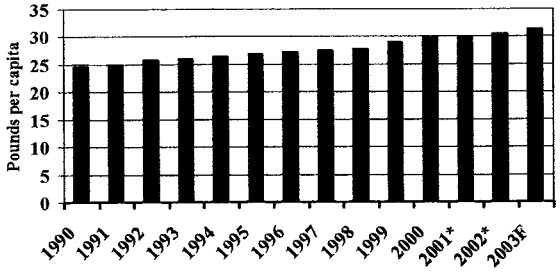
*Preliminary

3--Per Capita Butter Consumption has been Flat



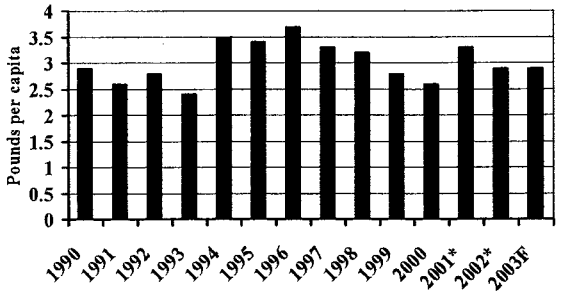
*Preliminary

4--Per Capita Cheese Consumption has been a Growth Market



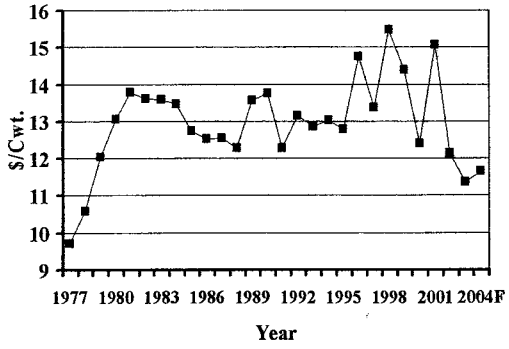
*Preliminary

5--Per Capita Nonfat Dry Milk Use Variable

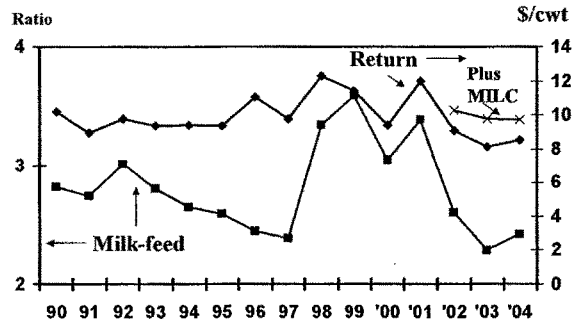


*Preliminary

6--All-milk Price Drops Again in 2003 with Gradual Recovery by 2004

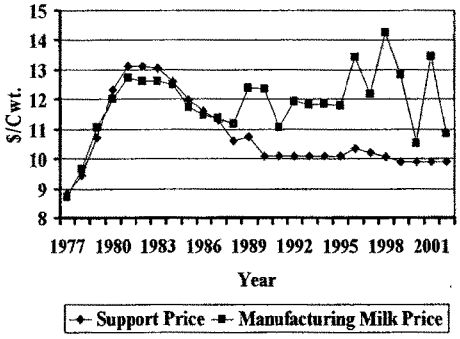


7--Milk-feed Price Ratio and Returns Down, but MILC Cushions the Drop 1/

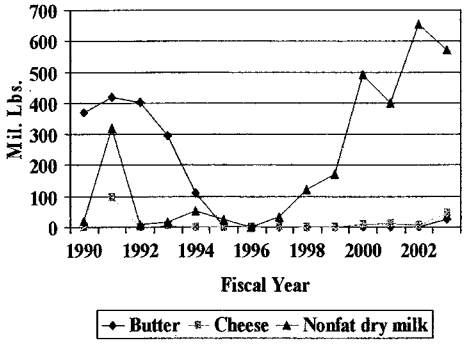


1/ Return over concentrate cost; MILC assumes no limit

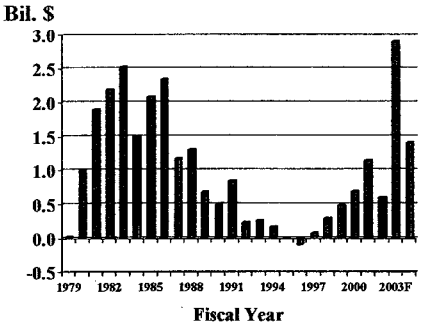
8--Price Variability Higher in Recent Years



9--Purchases of NFDM Continue at Strong Pace & Begin for Other Products



10--Milk Price and Income Support Program Costs Up Sharply 1/



1/ FY 2003 & 2004 from President's Budget for FY 2004

Testimony to
House Subcommittee on Department Operations, Oversight,
Nutrition and Forestry
By Robert Cropp
May 20, 2003

Mr. Chairman, my name is Robert Cropp. I am professor emeritus and Dairy Marketing and Policy Specialist with the University of Wisconsin-Madison. I have spent almost 37 years teaching, conducting research and delivering extension programs on milk pricing, dairy policy and dairy cooperatives. Thank you for inviting me to provide testimony at this important public hearing. I will briefly address each of the issues raised in the letter of invitation.

Current prices and outlook: Farm milk prices were depressed all of 2000 and the "all milk price" averaged just $12.40 per hundredweight compared to $14.36 the year earlier. Milk price recovered nicely during 2001 and averaged $15.01 per hundredweight, the second highest price on record. But prices took a tumble the end of 2001 and have been severely depressed ever since. Since July 2002, except for the month of October the base milk price Class III has been below $10.00 per hundredweight. The April all milk price was $10.90 per hundredweight, the second lowest price for April in 20 years.

The big question is, when will farm level milk prices turn around? Farm level milk prices are very responsive to relatively small changes in milk production and commercial disappearance. The strong prices in 2001 were the result of a decline in milk cow numbers and a decline in milk production of 1.0 percent. Milk cow numbers increased all of 2002, and total milk production was up 2.6 percent. This production increase would not have depressed milk prices as far if it was not for a very weak commercial sales of milk and dairy products, most important cheese sales. The annual increase in commercial disappearance of milk and dairy products from 1985 to up until 2001 was about 2 percent. But increases for both 2001 and 2002 were just 0.5 percent. Ever since September 11, 2001 tragedy and a slower growth in the economy consumer consumption patterns appear to have changed and this has dampened sales of milk and dairy products.

It is my opinion that milk prices have bottomed out and we will begin to see a slow recovery in milk prices. With the long period of low milk prices and an unfavorable milk feed price ratio (2.23 for April and far below a favorable ratio of 3.0 and higher) milk cow numbers should start to decline and milk production slow. Milk cow numbers from month to month were still increasing in March and were 0.9 percent higher than a year earlier. Milk per cow was up just 0.6 percent resulting in 1.5 percent more total milk production. But this increase in cow numbers and total milk production is concentrated in the West (see table below).

Cow numbers, milk per cow, and total milk production, selected states, March 2003 versus March 2002 (percent change)

State	Percent change in cows	Percent change in milk per cow	Percent change in total production
Arizona	4.9	-4.2	0.3
California	3.7	-0.3	3.4
Idaho	3.7	5.1	8.9
New Mexico	7.5	0.3	7.8
New York	1.6	-1.6	0.0
Pennsylvania	0.9	-1.8	-1.2
Missouri	-5.1	0.3	-4.3
Kentucky	-2.4	-7.6	-9.8
Florida	-2.6	-0.7	-1.8
Wisconsin	-1.0	2.0	0.9
Minnesota	-2.0	-0.3	-2.4
Iowa	-2.9	1.5	-1.5
United States	0.9	0.6	1.5

Source: USDA, NASS April Milk Production Report

There are more than ample supplies of dairy stocks. These stocks keep cheese, butter and nonfat dry milk prices depressed. March 31 stocks show total cheese at 769.9 million pounds, 5.2 percent higher than a year ago; butter at 242.1 million pounds, 66.8 percent higher than a year ago and end of February stocks of nonfat dry milk at 1,194 million pounds, 19 percent more than a year ago. But, with milk production slowing some and some shifting in milk utilization, the production of cheese and butter is now running below a year ago. Compared to March of last year, butter production was 0.9 percent lower, cheddar cheese production 4.8 percent lower and total cheese production 1.3 percent lower. Other than for nonfat dry milk where stocks are enormous, these stocks will not prevent a slow recovery in milk prices once cow numbers stop increasing and milk production slows further. We don't expect any major improvement in commercial milk sales in the near future, so the price recovery will depend heavily on a slow down in milk production. The Class III price was $9.41 per hundredweight in April. It should increase to about $9.80 for May, get in the low $10.00 range by June, reach close to $11.00 by July, reach close to $13.00 by September or October and then decline to around $12.00 for December. This would give an average all milk price for the year near $12.50 per hundredweight, only a slight improvement over the $12.40 average last year. Now I admit, this forecast is more optimistic than what USDA and many others are predicting. But again, farm level milk prices are very responsive to relatively small changes in milk production or milk sales. The type of weather this summer and fall as well as crop conditions can have a significant impact on where farm level milk prices end up.

Dairy Trade: Much attention is given to dairy imports. Dairy imports are often blamed as the major reason for the depressed farm level milk prices. Not to say that imports have no impact on farm level milk prices, they by far have a rather minor impact. Farm level milk prices are responding to the domestic supply and demand situation as mentioned above. U.S. still has rather stiff import protection.

U.S. dairy exports topped $1 billion for the third straight year in 2002. Dairy imports were higher, preliminary in the range of $1.02 billion to $1.89 billion in total value. On a total-solids basis, dairy imports were up 1 percent to 852 million pounds in 2002. This is equivalent to about 4 percent of U.S. milk production. But on a total-solids basis, dairy exports at 1.067 billion pounds outstripped imports by 215 million pounds, or 25 percent.

Most of recent attention has been on imported milk protein concentrates and their impact on farm level milk prices. While it makes good coffee shop talk that increase imports of milk protein concentrates are a big reason for low farm level milk prices, the facts don't bear this out. Imports of milk protein concentrates were about 10,000 metric tons in 1995, increased to 50,000 metric tons in 2000, declined to 30,000 metric tons in 2001, and were back to 35,000 metric tons in 2002, about a 17 percent increase. While milk protein concentrates increased 17 percent in 2002, imports of casein declined 8 percent. Perhaps some of the imported milk protein concentrates replaced casein imports.

Not all imports of milk protein concentrates are a substitute for domestic nonfat dry milk production. Nonfat dry milk has about 36 percent protein and carries with it lactose. Milk protein concentrates may have a protein content any whereas from the low 40 percent to close to 90 percent and do not contain the lactose content. Thus, the use of milk protein concentrates may not be just because it may be a lower cost of milk protein, but because of its superior functionality as compared to nonfat dry milk. So there are major differences in functionalities and uses. It is the lower protein content milk protein concentrates that likely substitute for domestic nonfat dry milk. Being rather generous in the potential substitution of milk protein concentrates for domestic produced nonfat dry milk, Dr. Ed Jesse, Professor and Dairy Economist at University Wisconsin-Madison estimated milk protein concentrates could have replaced 300 to 400 million pounds of domestic nonfat dry milk last year[1]. This displacement added to the burdensome CCC purchases of surplus nonfat dry milk. But, even if milk protein concentrates had been zero, the CCC would still have purchased a lot of surplus nonfat dry milk because total purchases were over 800 million pounds in 2002.

In summary, imports of milk protein concentrates do replace domestic nonfat dry milk. But the impact on farm level milk prices is greatly isolated because of CCC purchases on nonfat dry milk under the price support program. Imports of milk protein concentrates do add to the cost of the dairy price support program. It should be noted that the two recent butter/powder tilts not only reduces the cost of the dairy price support program, but made domestic nonfat dry milk a more price competitive source of milk protein.

Industry trends; farm structure and regional shifts: The structure of the dairy farms has experienced rather dramatic changes over the past 10 years and is likely to experience even greater changes over the next 10 years. The trend will be fewer and larger dairy operations regardless of any likely federal dairy policy adopted. Federal dairy policy can

[1] Jesse. Ed, **U.S. Imports of Concentrated Milk Proteins: What We Know and Don't Know,** Marketing and Policy Briefing paper, No. 80, February 2003, Department of Agricultural and Applied Economics, College Of Agricultural and Life Sciences, University of Wisconsin-Madison Cooperative Extension, University of Wisconsin-Extension. This paper may be accessed via www.aae.wisc.edu/future

slow down or speed up these structural changes, but not stop them from occurring. In 1990, there were about 193,000 dairy farms. Last year there were 91,900, a decline of over 52 percent. We could lose a third of the dairy herds over the next five years. This is very possible when one examines the existing dairy farm structure. Fort-eight percent of U.S. dairy herds have fewer than 50 milk cows and account for just 7.6 percent of the milk production (see the table below). Let's face it; these small operations cannot adequately support a family's living without substantial other sources of farm or off-farm income. Further, may of these operations have dairy facilities that are extremely outdated and often in poor condition. And further, most young people today do not want to milk 40 or 50 cows seven days a week. They prefer a larger and more modern dairy operation that will support two or more families and one that allows time off. So the structural change to larger two or more family dairy operations is not driven just by economics, but also as a better way of life for today's younger generation of dairy operators.

In contrast, 3.1 percent of the dairy farms have 500 or more cows and account for 41.9 percent of the milk production. In fact, herds of 1000 or more cows account for just 1.2 percent of the farms but 28 percent of the milk production.

Number of U.S. dairy operations and percent of milk production by herd size 2002

Herd size: number of cows	Percent of dairy operations	Percent of milk production
1 to 29	27.9	1.5
30 to 49	20.1	6.1
50 to 99	30.3	17.4
100 to 199	12.9	15.6
200 to 499	5.6	17.5
500 to 999	1.9	13.9
1,000 to 1,999	0.8	13.0
2000 plus	0.4	15.0
Total	100.0	100.0

Source: USDA, NASS, Milk Production Report, Feb. 14, 2003.

The regional shifts in milk production from some of the more traditional states in the Midwest and Northeast to the West will continue but slow some from what has occurred since 1990. The South and Southeast will likely experience a continue decline in milk production. But some Northeast and Midwest states have a good chance of stabilizing, if not starting to increase milk production. For example, Wisconsin and Minnesota have state initiatives to foster dairy modernization and expansions. One needs to recognize that the shift in milk production is not entirely related to farm level milk prices. Milk production is growing in states having the lowest farm level milk prices such as California, Idaho, New Mexico and Arizona. Milk production is experiencing some of the biggest declines in states having some of the highest milk prices such as Florida, Kentucky and Missouri. These are higher per hundredweight cost of production areas. Wisconsin and Minnesota have experienced static and declining milk production. Yet, these two states pay dairy producers more for milk used to make cheese than does any other state; as much as $1.00 or more per hundredweight than states like California and Idaho. Wisconsin and Minnesota need to modernize their dairy industry to be cost competitive with the growing West. The bottom line is that regardless of federal dairy policy, milk production will gravitate to where it can be produced, processed and

marketed the most competitively. As this happens, along with farm level structural changes already discussed, the cost of milk production will flatten among the regions that are most competitive cost wise, namely states in the Upper Midwest, West and Northeast. As this happens there also will be a narrowing of farm level milk prices among the regions. While farm level milk prices will continue to be very volatile, the long run trend in average yearly farm level milk price will be rather flat at around $13.00 per hundredweight. This price level will produce an adequate supply of milk to meet commercial beverage and manufacturing milk needs.

Effects of government programs: As already mentioned, government programs like the dairy price support program and the Milk Income Loss Contract Program (M.I.L.C.) can influence the rate of dairy farm structural changes but will not stop it. Without question the M.I.L.C. program this past year has been a great help to smaller dairy operations, those with 130 cows or less. M.I.L.C. payments on eligible milk averaged $1.206 per hundredweight for all of 2002. Adding this to the average all milk price of $12.40 nets, on the average, $13.606 per hundredweight. This is a price that is adequate for smaller dairy operations to cash flow. If it weren't for these M.I.L.C. payments, the financial situation would be much different on many of these smaller dairy farms. No doubt, many more would have exited the dairy business. To the extend that these smaller dairy operations did not exit, and some may have even added some cows to take full advantage of M.I.L.C. payments, the recovery from low milk prices has been slowed. To the extent a recovery of farm level milk prices have been slowed larger dairy operations, many that have made substantial capital investments and bought rather high priced dairy replacement heifers within the last couple of years have suffered as a result. But the objective of the M.I.L.C. program was to direct benefits to the smaller dairy operations. While most all dairy farmers would prefer getting their returns from better milk prices from the market place, the majority of U.S. dairy farmers are grateful for the M.I.L.C. payments. And further, for dairy producers located within regions of relatively higher manufacturing use of milk, like the states of Wisconsin, Minnesota, Idaho, California and others, the M.I.L.C. program is much preferable over regional dairy compacts. The M.I.L.C. program is a national and not a regional program like dairy compacts.

The $9.80 per hundredweight dairy price support program does provide limited safety net to farm level milk prices while allowing for market forces to work most of the time. But, the program needs serious consideration for change. Since 2001 through April 2003, the Class III price was below the $9.80 support price seven of the 16 months and may not reach support until June of this year. The Class III price got as low as $9.11 per hundredweight in March of this year. There are several possible reasons for this including CCC packaging and quality specifications that differ from commercial sales, additional cost of selling cheese to the CCC, and a large percentage of the cheese sold under contract to a buyer thus not enabling a cheese maker to sell to the CCC. Two suggested revisions in the existing price support program have been suggested. One by the National Milk Producers Federation that would increase the make allowance to reflect the added cost of selling to the CCC. Others have suggested that the CCC be an active buyer of cheese off of the Chicago Mercantile Exchange. These suggestions and possibly others need to be seriously examined, because clearly the price support program no longer

establishes the price protection as was originally intended. Further, the Secretary of Agriculture should be free from political pressure in adjusting the CCC purchase price of manufactured dairy products, for example in making butter/powder tilts. The Secretaries decision should be based on the intent of the dairy price support program, and that is, one that achieves its price support objective and minimizes government cost. Pressuring the Secretary to not make a butter/powder tilt, for example because it may lower the mover for Class I prices under federal milk marketing orders does not fit well with this objective of the dairy price support program.

Other thoughts for future federal dairy policy: If the objective of federal dairy policy is to support an efficient, competitive and growing dairy industry, then dairy policy should provide a limited safety net to dairy producers and allow the market forces to work. Dairy policy should be equitable to all regions and allow for needed dairy modernization or expansion. For example, both Wisconsin and Minnesota need to modernize their dairy industry, if they wish to competitively compete in a growing dairy industry in the long run. Dairy policy should not lock in obsolescence. Modern dairy production, processing, packaging and transportation technology no longer makes it necessary for each state or region to be self sufficient in local milk supplies to satisfy the market needs for either beverage milk and manufacturing milk uses. Dairy policy must be careful in attempting to generate higher revenues to dairy producers by increasing Class I prices and/or isolating Class I prices from market forces. Beverage milk sales have been flat and are not increasing. The Class I needs continue to take a smaller and smaller share of the total milk utilization pie. For 2002, Class I utilization for all 11 federal milk marketing orders combined was just 36.7 percent compared to 45.3 percent as recent as 1998. Most of the other 63.3 percent is used to make cheese, the growth area of the U.S. dairy industry.

If the objective of federal dairy policy is to preserve a dairy structure of smaller dairy farmers, this would require a mandatory strict supply management program. But, even with this, if production rights (quotas) are freely transferable, like is the case for the Canadian quota system, in the long run the trend to fewer and larger dairy operations will still occur. Further, the production rights get capitalized into the cost of milk production making it extremely difficult for new entrants into dairying.

Thank you for this opportunity to offer this testimony. I would be happy to respond to any questions.

Subcommittee on Department Operation, Oversight, Nutrition and Forestry
Testimony by Sidney E. Grove

Total pounds of milk production in the Southeast is not keeping up with increases in demand. Seasonal balancing of the milk supply is achieved by the purchase of milk outside of the area and transporting it in. The additional milk is needed to meet demand in late summer and fall. This balancing of the milk supply is expensive and an additional cost to dairy farmers.

A high percentage of Southeast dairy herds average about one hundred cows. There is a modest increase in size while the number of dairy farms slowly decline. Total milk production is down slightly, while demand for milk increases, particularly in the younger school age group.

Processing capacity in recent years has been increased by plant alteration and remodeling. Very few new processing facilities are being built as present capacity is adequate.

We know from past experience that the market for perishable products, whether it be milk or fruit or vegetables, over reacts to slight changes in the supply and demand balance. The market slump today is the result of a 2% surplus of supply over demand.

In the days of higher support levels, the peaks and valleys in pricing were not nearly so pronounced, nor were they so frequent. This is the case for increased price support levels to provide more stability in farm milk prices.

I am concerned that a market that behaves in an erratic manner with lots of peaks and valleys creates an opportunity for ever increasing profit margins for bottlers and retailers. The nation's largest fluid milk processor has recently reported quarterly earnings of $63 million and a 100% increase in the price of its stock over a three-year period. At the same time, dairy farmers are suffering from record low prices. Today, the dairy farmer receives only 33 cents of every consumer dollar spent on dairy products.

The price support program is a necessity for dairy farmers. Its current level of $9.90/cwt provides dairy farmers with some level of security as to the level that prices can fall. The price support program works by setting commodity price supports that equate to a $9.90 per hundredweight price for farmers. Currently, the commodity price supports are $1.1314 for block Cheddar cheese, $1.1014 for barrel cheese, $1.05 for

butter, and $0.80 for NFDM. However, for the last 5 months (November 2002-April 2003), the Class III milk price (milk used for the production of cheese) has been below the $9.90 support price. This is largely due to a burdensome process of making, packing, grading, and selling cheese to the Commodity Credit Corporation (CCC). A NMPF survey of manufacturing plants found that the cost of selling cheese to CCC was $0.056 per pound, the cost of selling butter to CCC was $0.015 per pound, and the cost of selling NFDM to CCC was $0.0225 per pound. With these additional costs involved, cheese manufacturing plants commonly wait until the market price for block cheese is below$1.10 before offering product to CCC. This causes the true support price to be below the intended level of $9.90 per hundredweight. If Congress intended to floor dairy producer prices at $9.90 per hundredweight, it is suggested that changes be made to the support prices in order to acknowledge the additional costs of selling product to the government.

Reducing imports of milk protein concentrate (MPC) and casein is a matter of grave importance for U.S. dairy farmers. When combined, imports of MPC and casein have been between 800 million and 1 billion pounds (nonfat milk equivalent) over the last 6 years. This has displaced domestically produced nonfat dry milk (NFDM) and is a leading factor in the buildup of huge government inventories of NFDM through the price support program.

From 2000 - 2002, New Zealand, the European Union, and Australia have accounted for over 90% of MPC imports and 86% of casein imports to the U.S. These imports have hurt U.S. dairy farmers. National Milk Producers Federation (NMPF) estimates that in 2002, U.S. dairy farmers lost $0.48 per hundredweight due to imports of these products. This amounts to a total dairy farmer loss of $817 million, and increases the cost of the MILC program.

Current legislation that has been introduced in the House of Representatives and the Senate, H.R. 1160, S. 560, respectively, would apply tariff-rate quotas to MPC and casein used in the human and animal feed industries. During GATT negotiations in 1994, MPC and casein were ignored in the conversion of quotas

to tariff-rate quotas, and therefore can come into the U.S. with a small duty of $0.0037 per kilogram ($0.0017 per pound). The proposed legislation would increase the duty to $1.56 per kilogram ($0.71 per pound) for MPC with up to 90% protein and $2.16 per kilogram ($0.98 per pound) for MPC with protein levels greater than 90%. Casein and casein products would also be assessed at a rate of $2.16 per kilogram. From January through March of 2003, imports of MPC were over 100% higher than January through March 2002. Over the same time period, casein imports are 35% higher than the previous year. We now have the technology for domestic production of MPC at a plant in Portales, New Mexico.

The current legislation has received wide bipartisan support. As of May 14, 2003, there were 119 cosponsors in the House of Representatives and 25 in the Senate. Opponents of this legislation say these imports represent a small share of our market, but we must remember we are out of balance only 2%, so there is big market impact here.

Milk Income Loss Contracts (MILC) was a new program made available to dairy producers in the 2002 Farm Bill. MILC payments work by setting a target price, and then paying dairy producers a portion of the difference between announced prices and the target price. The payments were subject to an annual 2.4 million pound cap (approximately 130 cows). Producers who have annual production above 2.4 million pounds are eligible to receive MILC payments up till the time they reach their cap. Since initiation of the program (payments started in September 2002), dairy producers across the country have received over $1.376 billion in additional farm revenue due to the MILC payments. In a time of historically low prices, this additional revenue has made the difference for many farmers when faced with the decision to continue farming or to exit the business.

The MILC Program has been a very positive and helpful buffer to the average and smaller size producers in the region. It has allowed the more efficient producer to operate at near break-even or a cash neutral position as opposed to losing equity. As a side note, a more active or higher price support program might have eliminated the need for the MILC Program.

Sometimes in making policy, we tend to feel there are just too many dairy farmers - so why not let some of them fall by the wayside, particularly the inefficient ones. In making policy, we need to remember - the problem is not too many dairymen, but too many cows. When a farm ceases to operate, the cows land on another farm where they may be treated better and produce more milk than before. In addition, in the rural areas of the Southeast that depend on the economic contribution from dairy farms, the consequences, social and economic are profound when a farm goes out of business.

A Federal Milk Marketing Order is a tool that helps dairy farmers collect their fair share of the consumers' dollar paid for dairy products. Consumers place different value on the milk they consume. For example, consumers are willing to pay more for a glass of milk, which will spoil quickly, than a bite of cheese that can be bought on sale and stored in the refrigerator for a while. The process is the same as a seat on the airplane. The airline doesn't get more for the first class seat because they just charge more, but because someone thinks there is more value and is willing to pay more. In the dairy industry the Federal Order is in

place of the pilot who won't let the plane take off until everyone is in the correct seat. Federal Orders have been around since the 1930s - leveling the playing field for dairy farmers. While some say they are no longer needed, it does not look like that to me. The retail grocery industry is getting more and more concentrated. Retailers are not bad guys - I need a grocery store to sell milk. But as they get bigger and bigger, they will naturally try to use their size to negotiate lower price from suppliers. What chance does one (or one hundred) dairy farmers have in negotiating prices with Wal-Mart?

We still need Federal Orders to set minimum prices, make sure that the terms of trade are clear to all buyers and sellers and insure fair accounting of what was sold and what was bought. Orders also tell the market all of this information in a way that is clear to all parties who want to know about it. They are completely paid for by the marketplace and not the taxpayer. Furthermore, without the Order that tells farmers that everyone will share in the minimum prices equally, we too will race to undercut one another until no one has a margin and goes out of business. Remember Orders set minimum prices - they still leave room to negotiate some premiums for quality and service - but without them the minimum prices would be set by the biggest negotiator and that would be the buyer - not the farmer.

The Dairy Export Incentive Program (DEIP) is also a beneficial for U.S. dairy producers. DEIP allows domestically produced dairy products to be exported by awarding bonuses to marketers of dairy products. The level of product that is eligible for DEIP is based upon WTO rules. In the July 1, 2002 - June 30, 2003 DEIP year, the U.S. was allowed to subsidize over 150 million pounds of NFDM, 6.68 million pounds of cheese, and 45.5 million pounds of butterfat. This DEIP year, USDA has awarded the allowable limits for NFDM and cheese, but still has a substantial amount of butterfat available for export (35.5 million pounds). With domestic butter prices currently hovering within $0.05 of the support price, issuance of invitations for the remaining butterfat would be beneficial to U.S. dairy farmers.

In summary, I call for more effort and focus to make the programs we have work as intended:

1. The Dairy Export Incentive Program still has 35.5 million pounds of butterfat available for export. Why have we not issued invitations for this product to be exported?

2. If the price support is intended to floor prices at $9.90 per hundredweight for dairy farmers, why are prices being allowed to fall below this level? A higher price support level could have prevented the need for the MILC Program and could return the price stability we experienced in past decades.

3. Passage of HR 1160 and S. 560 could prevent the loss of another 800 million or more dollars in dairy farmers income in 2003.

4. The Federal Order System is still needed to set minimum prices in the marketplace and to protect dairy farmers from the negotiating powers of mega-retail marketers.

5. The recent changes in the butter powder tilt has adversely affected dairy producers in the Southeast and has increased the cost of the MILC Program.

6. USDA must comply with its charge and fully inspect foreign plants that are exporting to the U.S. to ensure food safety and product quality to the American consumer.

7. If the MILC Program is continued in conjunction with programs listed above, I believe most dairy farmers will be able to continue in business through the summer months and into fall as an anticipated recovery occurs. Should a recovery not occur during this time frame, I would expect many dairymen will exit the business to salvage remaining equity in their farms.

Good morning, Chairman Gutknecht, Ranking Member Dooley, and the other members of this subcommittee.

I am Jerry Kozak, the President and Chief Executive Officer of the National Milk Producers Federation in Arlington, Virginia. NMPF is the national voice of 60,000 dairy producers, and 33 cooperatives, here on Capitol Hill and with government agencies. We develop and carry out policies that advance the well-being of U.S. dairy producers and the cooperatives they collectively own.

Mr. Chairman, I won't sugarcoat the point I wish to make today: the state of the U.S. dairy producer community is deplorable. A few weeks ago, the USDA announced that the April all-milk price is $10.90 per hundredweight – that's the lowest level since 1978. So when you hear from your constituents about receiving the lowest prices in 25 years, they are absolutely right. And they are absolutely terrified that this price drought will continue throughout the year.

In the brief time allotted me this morning, I can't possibly go into every factor behind the depression in dairy farming. You've already heard one perspective from USDA's Keith Collins. My contribution here is not to take issue with USDA's explanations – but to take issue with the U.S. Agriculture Department itself, and how it has mishandled the management of many dairy policies that are intended to help producers. The programs we have in place – many of them created by Congress – are fine. But the way they have been administered lately is anything but fine. The USDA has had many chances to be part of the solution, but for whatever reason, they remain part of the problem. These programs are tools that, if used properly, could do a great deal of good. But these tools are be used inadequately at best. Let me list five examples.

#1

First, the outcome of the 2002 Farm Bill. Dairy producers approached the formulation of the Farm Bill with a greater degree of unanimity than at anytime in recent memory. We agreed on what we wanted, and thanks to a collaborative effort, we expressed our views to Congress, and the resulting Farm Bill reflected those needs. Our number one objective was extension of the dairy price support program. It is dairy's best safety net; no other program gives producers more

bang for the buck. But the USDA is not operating the price support program in a way that is supportive of dairy farmers.

The law that Congress passed stipulates that the USDA should provide a modest price floor of $9.90 per hundredweight for producer milk prices by offering to purchase cheese, butter and skim milk powder at levels that will return $9.90 to producers. Chart #1 illustrates the prices for Class III and Class IV milk during the past 12 months. Clearly, the program is not living up to its obligations, particularly in Class III.

We believe that the Department is failing in its statutory obligation to maintain purchase price levels for butter and powder, and especially for cheese, that allow an average plant to return the $9.90 milk support price to farmers. Their failure to cover the full cost of manufacturing for, and marketing to, the Commodity Credit Corporation has led directly to the cheese milk prices falling well below the support price of $9.90 in three of the last four years, including $8.57 in the fall of 2000 and $9.11 this March. NMPF did an extensive survey within its membership of the additional cost of selling product to the CCC. Based on the survey data, we offered the Department specific recommendations to address this problem, and have received no response. I am submitting for the record a copy of our letter to the USDA.

Compounding the problem has been the way the USDA has devastated dairy producer income by adjusting the price support purchase "tilt" between butter and powder. Primarily in an attempt to reduce its purchases of milk powder, the USDA has reduced its offering price for nonfat dry milk by 20% since May 2001. Rather than saving money through these reductions, the agency has created a "lose-lose" situation. As Chart #2A shows, the tilts have cost dairy farmers nearly $1.5 billion in lower prices. What's worse, we project that the tilts will have a continued detrimental impact on prices in the range of $2.4 billion through the end of this year.

But as Chart #2B shows, the tilts have also cost USDA an additional $56 million, in higher net expenditures. While the CCC's milk purchases have been reduced only slightly, because the tilt raises butter's support level even as it drops the powder price, USDA is now also buying butter, more than 10 million pounds to date. The cost of these butter purchases, plus the higher cost of

the milk payments, quickly overwhelmed the savings on nonfat dry milk purchases. And because both tilts have reduced farmer prices, the cost of the government's M.I.L.C. program has also jumped.

So let me make this clear: the USDA's mismanagement of the price support program has cost taxpayers and farmers more money than if they would have left the butter/powder purchase prices alone. Mr. Gutknecht, as a senior member of the Budget Committee, you should be very upset at the poor fiscal decisions the USDA has made.

#2

Second, the USDA has failed to make full use of the Dairy Export Incentive Program. The DEIP is a vital tool for the U.S. dairy sector to compete with heavily subsidized products coming from Europe, among other places. Like the price support program, the DEIP was also reauthorized and extended in the 2002 Farm Bill. Under the DEIP, the USDA can offer export assistance on over 21 thousand metric tons of butter in the year ending June 30. To date, despite record low milk prices; despite other countries' free use of their WTO-allowed export subsidies; despite a clear overseas demand for U.S. butter; and despite growing inventories of government-purchased butter; the Department has issued invitations for a mere 5,000 metric tons under this program, less than one-quarter of what is allocated. This is inexcusable.

Full use of the DEIP program would save USDA money overall by reducing their purchases of butter under the price support program and so reducing their butter inventories; it would raise producer prices – even if only modestly and for a short time; and it would strengthen our position in the current WTO negotiations. As Chart #3 illustrates, we estimate that the 5,000 tons of butterfat awarded under the DEIP in March increased wholesale butter prices by only six cents a pound. But to farmers, that translated into a revenue boost of between $20 million and $30 million because their all-milk price rose about 18 cents a hundredweight. We calculate that exporting the remaining DEIP butter would increase U.S. dairy producer income by between $80 million and $120 million this year.

The Department now has only six weeks to issue invitations for the remaining 16 thousand metric tons. I hope this committee will demand that they do so.

#3

Third, in its administration of the Milk Income Loss Contract program, the Department disenfranchised a large swath of medium sized producers in the way it implemented the program. Rather than offer equitable transition payments for the period prior to October 2002, the USDA chose a method of payment that maximized the payout for the small and the very largest producers, penalizing mid-sized producers who represent the future of the family dairy farm. Chart #4 illustrates how this middle group of producers was disadvantaged by a lower overall payment rate than either small or large farmers, who received much higher payment rates.

NMPF provided Secretary Veneman's office with a legal analysis demonstrating that the USDA had the discretion to use the average monthly payment rate for the MILC program, which is what the dotted line on Chart #4 depicts. That counsel went unheeded.

#4

Fourth, the USDA responded last year to the drought affecting much of the country, in part by providing compensation to affected livestock producers. That's all well and good. However, the drought disproportionately affected regions with especially large farmers, who were often disqualified from assistance by the Department's decision to limit eligibility on farm size, so that those hardest hit by drought were also hardest hit by the Department.

The Farm Service Agency did administer a drought assistance program last year that was effective. The program offered government nonfat dry milk inventories to help feed drought-affected cattle, sheep, and goat foundation herds that don't normally consume dairy products. This assisted producers without disrupting commercial dairy markets, and we encouraged these efforts to make use of these inventories in ways that do not disrupt markets and further depress prices.

This year, however, USDA chose to bypass experienced FSA staff and allow the target states – who have do not have experience with such programs – to write their own rules. Only after a united outcry by manufacturers of whey products did the Department tighten the provisions of their agreements with the states to prevent a major disruption of commercial dairy markets.

#5

Fifth, the 2002 Farm Bill also included a provision that requires that dairy exporters who sell their products in the U.S. pay their fair share to help promote dairy consumption. The purpose of promotional checkoff programs – and dairy was the first major one back in 1984 – is to build demand and encourage consumption. Dairy imports have risen to record levels in recent years – that's one of the causes of these low prices. Importers are taking advantage of the largest, most lucrative dairy market in the world, and all we are asking is that they pay the same checkoff promotion assessment that farmers pay in Minnesota and California and everywhere else.

But the USDA has yet to implement the promotion assessment, even though by my calendar, the Farm Bill passed 53 weeks ago today. We understand that part of the delay – which, by the way, is a violation of the law – is because the U.S. Trade Representative's office is holding things up. I urge this committee to work with the USTR, the USDA and any other Administration agencies to see that the intent of this Congress is not thwarted.

Finally, let me speak to the one legislative measure that is a top priority for NMPF today. I just mentioned that imports of products like Milk Protein Concentrate are affecting the U.S. market. In many cases, these MPC's are little different from the nonfat dry milk powder that we are accumulating in large volumes. We overlooked MPC's in our last trade negotiations, but our trading partners did not. They recognized their potential and they protected their markets; but we left a loophole through which 804 million pounds (nonfat milk equivalent) of casein and MPC imports came last year. This compares with 556 million pounds in 1993, as illustrated in Chart #5. The growth of these imports has resulted much more from this loophole than from any substantive benefits they offer distinct from U.S.-produced dairy ingredients. Together, the economic impact of these imported dairy proteins has had an enormous impact on dairy farm

revenue – an estimated $3.5 billion since 1993. And this hemorrhage of money can only be staunched by HR 1160.

To date, 121 members of the House have signed on as sponsors of H.R. 1160, and 25 Senators have signed on to S. 560. These bills would cap the free import of these products in a way that is consistent with our international trade obligations and that would strengthen our position in agricultural trade negotiations. Above all, this legislation is crucial to preventing the further erosion of our entire milk pricing structure. I urge you to support these measures.

In conclusion, I hope that your oversight of the Department can effect some changes in the current administration of USDA's dairy programs. Dairy farmers today are desperate. They need a friend in USDA; instead, they are losing faith in an agency that has an economic tin ear. My last chart, #6 shows the all-milk price since the beginning of 2001, when the current USDA team came into office. We have noted the two tilt adjustments. While I appreciate the time you've given me to speak on behalf of the dairy producer community, I think this chart speaks for itself.

Thank you for your attention.

APPENDIX

Chart #1 - 12 Months of Milk Prices
Per Hundredweight
$11.00
$10.80
$10.60
$10.40
$10.20
$10.00
$9.80
$9.60
$9.40
$9.20
$9.00
May-02
Jun-02
Jul-02
Aug-02
Sep-02
Oct-02
Nov-02
Dec-02
Jan-03
Feb-03
Mar-03
Apr-03
Cl. III
Cl. IV
Support

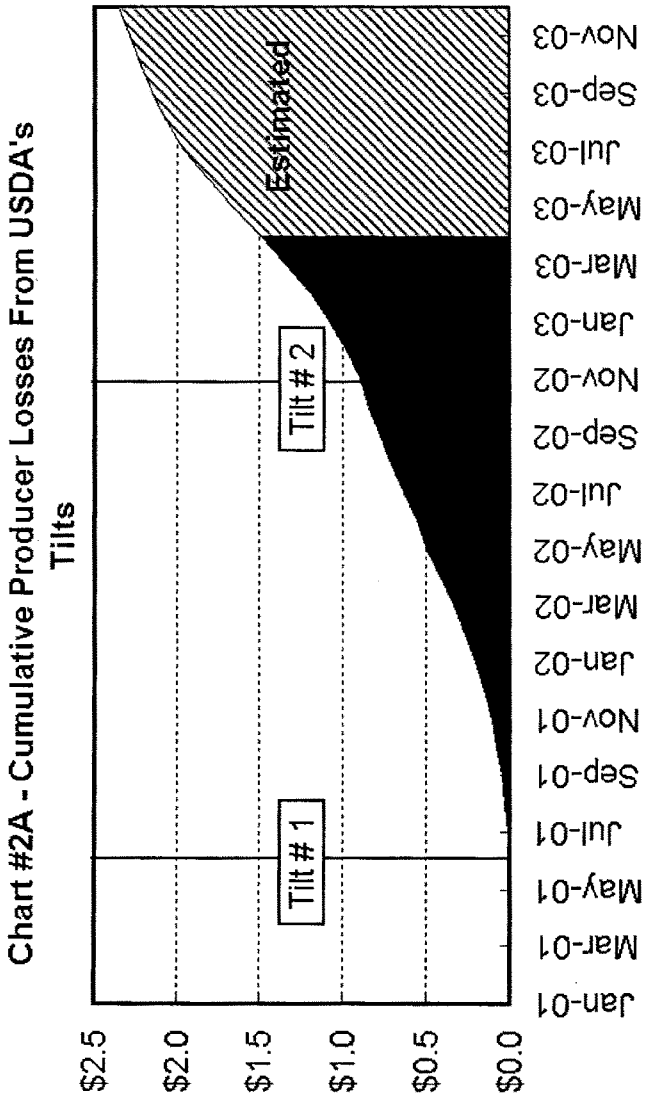


Chart #2A - Cumulative Producer Losses From USDA's Tilts
Estimated
Tilt # 1
Tilt # 2
$2.5
$2.0
$1.5
$1.0
$0.5
$0.0
Jan-01
Mar-01
May-01
Jul-01
Sep-01
Nov-01
Jan-02
Mar-02
May-02
Jul-02
Sep-02
Nov-02
Jan-03
Mar-03
May-03
Jul-03
Sep-03
Nov-03

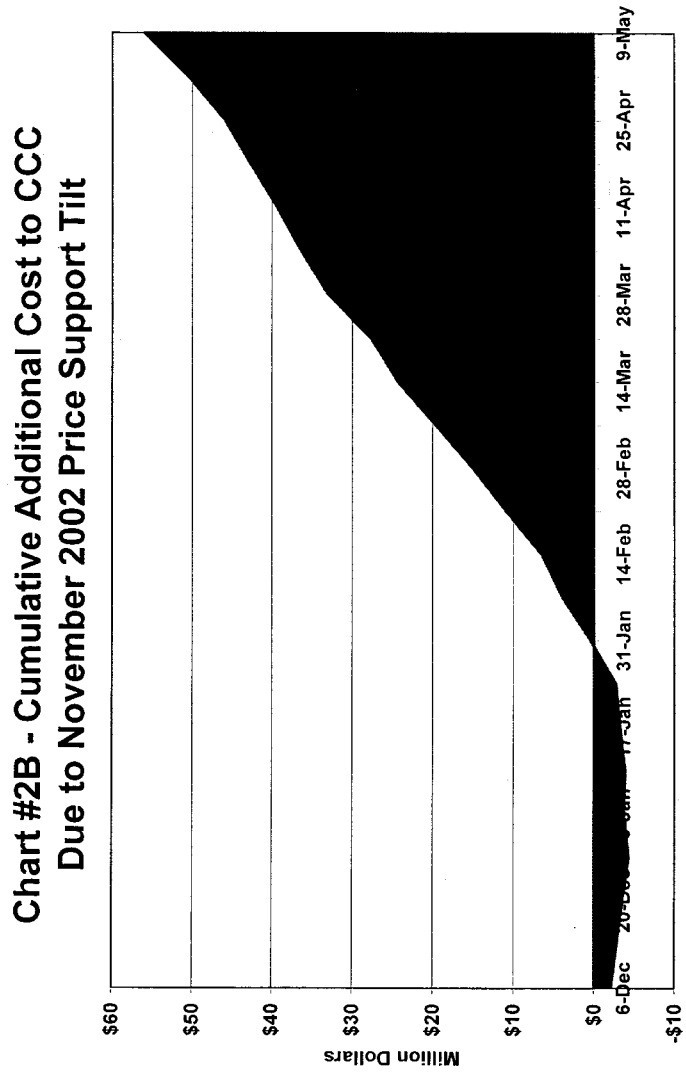


Chart #2B - Cumulative Additional Cost to CCC
Due to November 2002 Price Support Tilt
Million Dollars
$60
$50
$40
$30
$20
$10
$0
-$10
6-Dec
31-Jan
14-Feb
28-Feb
14-Mar
28-Mar
11-Apr
25-Apr
9-May
Week Ending

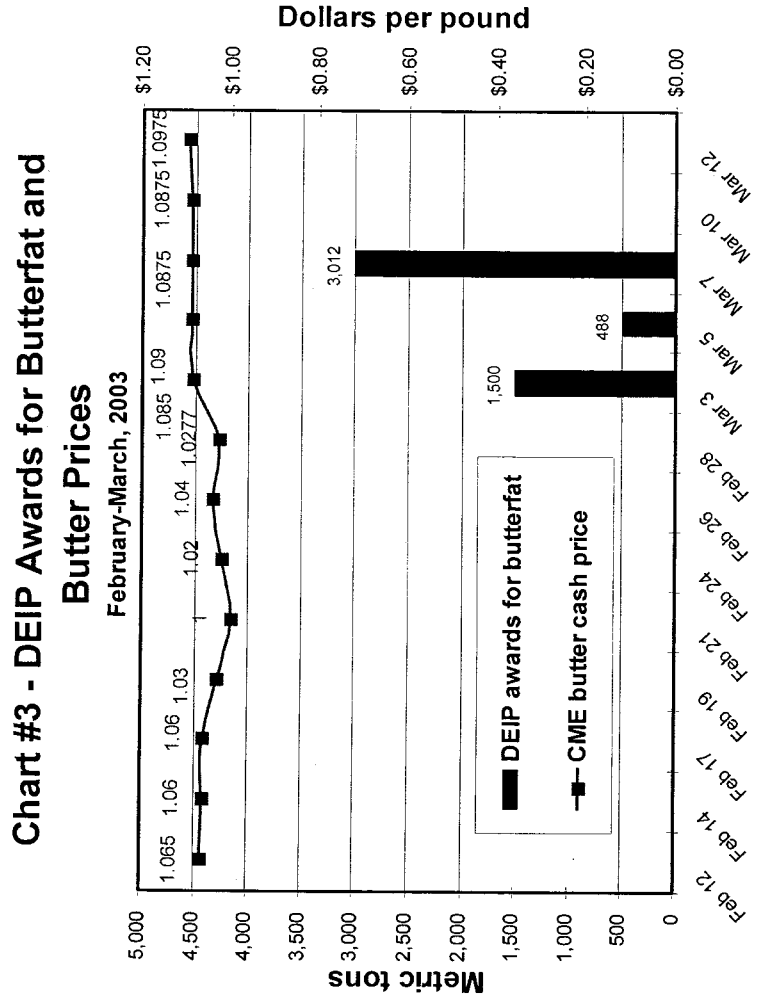


Chart #3 - DEIP Awards for Butterfat and Butter Prices
February-March, 2003
Dollars per pound
Metric tons
DEIP awards for butterfat
CME butter cash price
1.065
1.06
1.06
1.03
1
1.02
1.04
1.0277
1.085
1.09
1.0875
1.0875
1.0875
1.0975
1,500
488
3,012
$1.20
$1.00
$0.80
$0.60
$0.40
$0.20
$0.00
5,000
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0
Feb 12
Feb 14
Feb 17
Feb 19
Feb 21
Feb 24
Feb 26
Feb 28
Mar 3
Mar 5
Mar 7
Mar 10
Mar 12

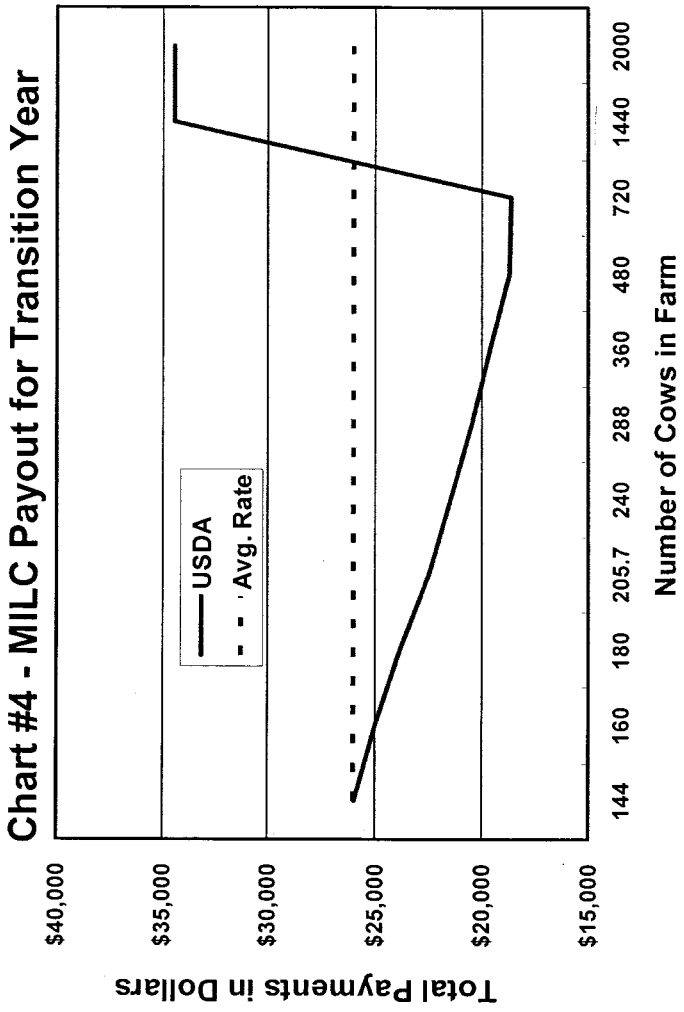


Chart #4 - MILC Payout for Transition Year
Total Payments in Dollars
$40,000
$35,000
$30,000
$25,000
$20,000
$15,000
USDA
Avg. Rate
144
160
180
205.7
240
288
360
480
720
1440
2000
Number of Cows in Farm

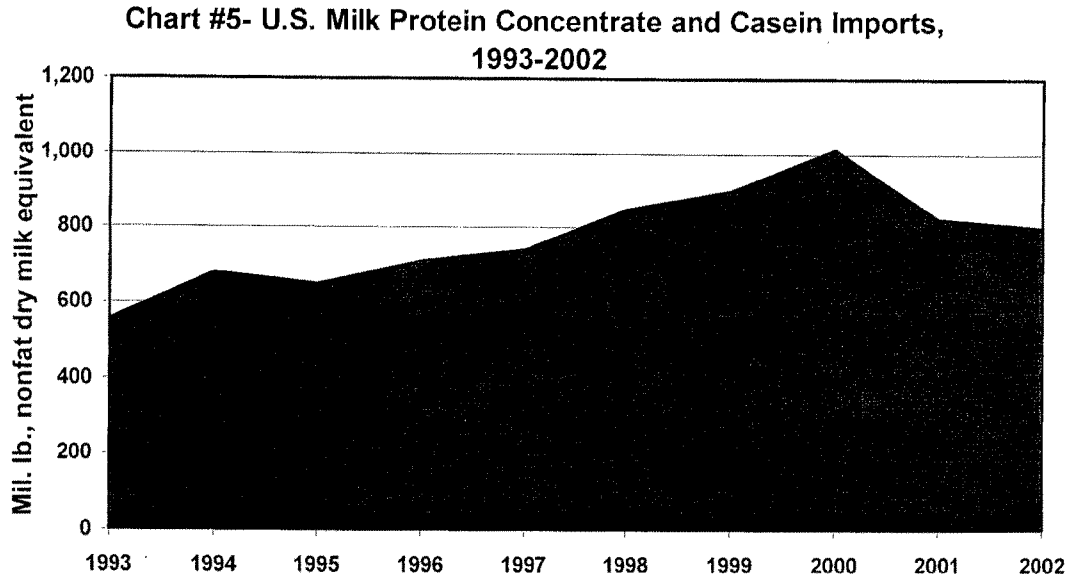


Chart #5- U.S. Milk Protein Concentrate and Casein Imports, 1993-2002
Mil. lb., nonfat dry milk equivalent
1,200
1,000
800
600
400
200
0
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002

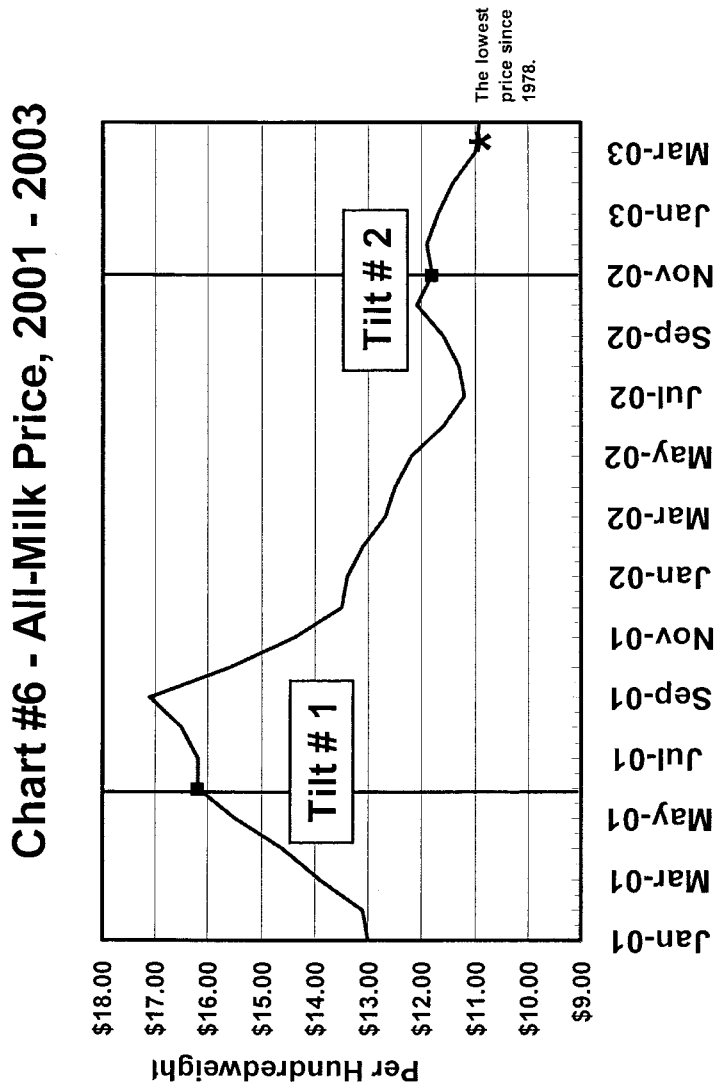


Chart #6 - All-Milk Price, 2001 - 2003
Per Hundredweight
$18.00
$17.00
$16.00
$15.00
$14.00
$13.00
$12.00
$11.00
$10.00
$9.00
Jan-01
Mar-01
May-01
Jul-01
Sep-01
Nov-01
Jan-02
Mar-02
May-02
Jul-02
Sep-02
Nov-02
Jan-03
Mar-03
Tilt # 1
Tilt # 2
The lowest price since 1978.

CCC TILT COST ANALYSIS												
CCC Operating Week					Weekly CCC Purchases		Savings on CCC Nonfat Dry Milk Purchases @ $.10/lb.	Additional Cost of CCC Butter Purchases @ $1.05/lb.	Average Increase in MILC Payment Rate	Additional Cost of MILC Payments	Total Weekly CCC Savings (Costs)	Total Cumulative CCC Savings (Costs)
					NDM	Butter						
					pounds	pounds	dollars	dollars	$ per cwt.	dollars	dollars	dollars
Dec	2	-	Dec	6	21,214,617	0	$2,121,000	$0	$0.00	$0	$2,121,000	$2,121,000
Dec	9	-	Dec	13	7,186,560	0	$719,000	$0	$0.00	$0	$719,000	$2,840,000
Dec	16	-	Dec	20	6,759,823	0	$676,000	$0	$0.00	$0	$676,000	$3,516,000
Dec	23	-	Dec	27	8,246,054	0	$825,000	$0	$0.00	$0	$825,000	$4,341,000
Dec	30	-	Jan	3	5,095,075	0	$510,000	$0	$0.06	$1,115,000	-$605,000	$3,736,000
Jan	6	-	Jan	10	20,807,174	0	$2,081,000	$0	$0.11	$1,952,000	$129,000	$3,865,000
Jan	13	-	Jan	17	13,379,406	0	$1,338,000	$0	$0.11	$1,952,000	-$614,000	$3,251,000
Jan	20	-	Jan	24	18,255,059	380,835	$1,826,000	$400,000	$0.11	$1,952,000	-$526,000	$2,725,000
Jan	27	-	Jan	31	13,750,918	1,987,963	$1,375,000	$2,087,000	$0.14	$2,476,000	-$3,188,000	-$463,000
Feb	3	-	Feb	7	22,754,276	84,546	$2,275,000	$89,000	$0.31	$5,622,000	-$3,436,000	-$3,899,000
Feb	10	-	Feb	14	15,235,879	-1,437,889	$1,524,000	-$1,510,000	$0.31	$5,622,000	-$2,588,000	-$6,487,000
Feb	17	-	Feb	21	15,984,407	380,780	$1,598,000	$400,000	$0.31	$5,622,000	-$4,424,000	-$10,911,000
Feb	24	-	Feb	28	18,361,751	380,742	$1,836,000	$400,000	$0.31	$5,565,000	-$4,129,000	-$15,040,000
Mar	3	-	Mar	7	14,296,586	761,945	$1,430,000	$800,000	$0.29	$5,225,000	-$4,595,000	-$19,635,000
Mar	10	-	Mar	14	14,400,067	846,240	$1,440,000	$889,000	$0.29	$5,225,000	-$4,674,000	-$24,309,000
Mar	17	-	Mar	21	22,841,267	380,771	$2,284,000	$400,000	$0.29	$5,225,000	-$3,341,000	-$27,650,000
Mar	24	-	Mar	28	10,635,864	1,134,611	$1,064,000	$1,191,000	$0.29	$5,225,000	-$5,352,000	-$33,002,000
Mar	31	-	Apr	4	22,959,151	970,529	$2,296,000	$1,019,000	$0.26	$4,629,000	-$3,352,000	-$36,354,000
Apr	7	-	Apr	11	18,122,382	380,881	$1,812,000	$400,000	$0.24	$4,390,000	-$2,978,000	-$39,332,000
Apr	14	-	Apr	18	18,174,710	761,623	$1,817,000	$800,000	$0.24	$4,390,000	-$3,373,000	-$42,705,000
Apr	21	-	Apr	25	21,019,414	888,426	$2,102,000	$933,000	$0.24	$4,390,000	-$3,221,000	-$45,926,000
Apr	28	-	May	2	13,879,091	634,671	$1,388,000	$666,000	$0.29	$5,303,000	-$4,581,000	-$50,507,000
May	5	-	May	12	23,979,950	1,257,824	$2,398,000	$1,321,000	$0.36	$6,521,000	-$5,444,000	**-$55,951,000**

National Milk Producers Federation

National Milk Producers Federation • 2101 Wilson Blvd., Arlington, VA 22201 • 703-243-6111 FAX 703-841-9328

February 26, 2003

The Honorable J.B. Penn
Under Secretary for Farm and Foreign Agricultural Services
U.S. Department of Agriculture
14th & Independence Avenues, SW
Washington, DC 20250

Dear Mr. Under Secretary:

The National Milk Producers Federation (NMPF) requests that the Commodity Credit Corporation (CCC) take immediate action and adjust the support program purchase price levels for cheese, butter and nonfat dry milk to reflect the significant additional costs manufacturers face when selling products to the CCC. The current CCC purchase prices for dairy products do not reflect any costs beyond those incurred for commercial sales. As a result, market prices for individual products have fallen below support levels, allowing the price of milk used to produce them to fall below the statutory support level for milk of $9.90 per hundredweight at average test.

For example, in eleven of the thirty-seven months since January 2000, the Class III price has fallen below the support price, by an average of 38 cents per hundredweight below the support level, which is equivalent to $9.80 for milk testing 3.5% milkfat and 8.7% solids not fat. The CME futures prices currently indicate that the Class III price will fall well below support again this month and the next two months as well.

Class III milk prices have fallen below the milk price support level, and cheese prices have fallen below their respective CCC purchase price levels, because the CCC dairy commodity purchase prices are not sufficient to cover the significant additional costs manufacturers face when they sell products to the CCC. As a result, manufacturers often sell dairy commodities to commercial customers at prices well below the CCC support purchase prices. During the months for which the Class III prices have been below support, market prices for cheddar block and barrel cheese have been several cents below their respective support purchase prices. The dairy price support program, therefore, is not currently effective in supporting the price of milk at the statutory price support level.

Grading is especially problematic for sales to CCC because it is often performed by a variety of graders unfamiliar with the plant, even when more customary grading may be performed by an in-house grader.

Additional administrative costs: Selling to the government under any circumstances typically involves additional paperwork and delay, due the unwieldy nature of most government procurement processes. Price support sales impose many of these costs, which are magnified when such sales are occasional, as has been the case for cheese.

Transportation costs: The freight rates allowed by the CCC are not adequate to compensate shippers, and add as much as 2¢ per pound to the costs of some plants.

Costs associated with grading rejections: The relatively high rate of rejection by graders using the CCC specifications have imposed additional costs on processors. If the rejection rate is 50%, this roughly doubles the additional costs per pound of product actually sold to the CCC. If rejection by graders forces sale to commercial customers at a discount to normal commercial prices, this raises costs further. In this survey, the impact of rejection per pound of product sold to the CCC was calculated as follows:

= (cost per intended lb. + (discount on rejects x reject rate)) ÷ acceptance rate.

Attached, for your review, is a copy of the survey form we sent to our member cooperatives as well as to proprietary manufacturers to determine these costs, together with a compilation of the data from the surveys we received.

NMPF staff and I request a meeting with you or your technical staff as soon as possible to discuss our request and the plant cost survey on which it is based. It is critical that the dairy price support program work as the Congress intended. Making the requested adjustments to the commodity purchase prices will not only help to insure that the program does satisfy this intention, but such action will also provide support to our dairy farmers at a time when they need it the most.

Sincerely,

Jerome J. Kozak

Jerome J. Kozak,
President and Chief Executive Officer

Enclosures (2)

cc: The Honorable Ann M. Veneman, Secretary of Agriculture

To measure more precisely the additional costs of selling to CCC, NMPF has undertaken a survey of manufacturing plants that have sold dairy products to the CCC under the price support program. Based on that survey, we request that USDA adjust the CCC dairy commodity purchase prices as follows:

- Increase the cheddar cheese purchase price 5.6¢ per pound to $1.1874 for blocks and $1.1574 for barrels (preserving the current 3-cent block-barrel differential)
- Increase the nonfat dry milk purchase price 2.25¢ per pound to $0.8225
- Increase the butter purchase price 1.5¢ per pound to $1.065

This will compensate dairy product manufacturers for the additional costs they incur when selling product to the CCC under the price support program and permit the dairy price support program to operate as Congress intended. The farm bill requires that the CCC price support purchase prices for dairy products "shall be sufficient to enable plants of average efficiency to pay producers, on average, a price that is not less than the rate of price support."

These additional costs, and the manner in which we have quantified them through our cost survey, are as follows:

Additional storage costs: Because the CCC is slower than commercial buyers to take delivery, sellers incur storage costs greater than when they sell to commercial customers. This is calculated as the additional days between the manufacture and shipment ("make to ship"), times a daily cost of storage per pound.

Additional finance costs: Because there is generally a longer time between the manufacture and payment ("make to pay"), sellers incur additional financing costs when selling to the CCC. This cost is calculated as the additional days from "make to pay", times a daily financing cost per pound.

Grading fees: CCC's grading specifications exceed that of any commercial customer. In many cases, sales to commercial customers require no grading based on the established quality of the seller's product. Even where grading is customary, the grading costs associated with sales to CCC are greater.

Packaging costs: In many cases, the packaging required by the CCC is more expensive than that typically used in commercial applications. This can be because of the CCC's requirement for longer storage or because the CCC's "Dairy-5" specifications are no longer consistent with industry standards.

Additional processing and finishing costs: Many sellers to the CCC are forced to take additional care in processing and finishing the product prior to sale. This may be done to meet such CCC specifications as a perfectly smooth surface on blocks of butter or to minimize the grading rejection rate of a somewhat subjective grading process.

Enclosure 1: Costs of Selling Dairy Products under the Price Support Program **National Milk Producers Federation**

Product:		Block Cheddar Cheese	Butter	Nonfat Dry Milk
Number of Plants:		No. of plants: 6	No. of plants: 6	No. of plants: 8
		(weighted averages)	(weighted averages)	(weighted averages)
Volume sold to CCC since 10/1/2000:		698,869	536,000	130,442,320
Calculated volume made for CCC:		1,025,503	597,745	135,796,293
Days from make to ship	Difference (CCC - Commercial)	42.6	18.3	4.7
Storage costs ($/lb./day)		$0.00020	$0.00017	$0.00009
Additional storage costs ($/lb.)*		**$0.0085**	**$0.0029**	**$0.0003**
Days from ship to pay	Difference (CCC - Commercial)	-1.2	-3.2	-19.7
Days from make to pay	Difference (CCC - Commercial)	41.4	15.0	-15.0
Finance costs ($/lb./day)		$0.000196	$0.000170	$0.000063
Additional finance costs ($/lb.)*		**$0.0082**	**$0.0059**	**$0.0013**
Additional grading fees ($/lb.)	Difference (CCC - Commercial)	**$0.0099**	**$0.0011**	**$0.0038**
Additional packaging costs ($/lb.)	Difference (CCC - Commercial)	**$0.0000**	**$0.0008**	**$0.0060**
Additional processing and finishing costs ($/lb.)		**$0.0099**	**$0.0034**	**$0.0088**
Additional administrative costs, incl. mailing, clerical time, etc. ($/lb.)		**$0.0000**	**$0.0007**	**$0.0007**
Other additional CCC-specific costs ($/lb.)		**$0.0000**	**$0.0000**	**$0.0006**
Total additional costs (per pound intended for sale to CCC)		**$0.0365**	**$0.0147**	**$0.0216**
Acceptance rate (%)		68%	90%	96%
Discount on rejects, compared to commercial sales		$0.0000	$0.0000	$0.0000
Total additional cost ($ per pound actually sold to CCC)		**$0.0564**	**$0.0151**	**$0.0224**

= (cost per intended lb. ÷ acceptance rate) + (discount on rejects x (reject rate ÷ acceptance rate))

* Some plants did not report intermediate calculations for additional storage and finance costs.

February 26, 2003

William "Bill" Rowekamp

U.S. House Agriculture Committee

Department Operations, Oversight, Nutrition and Forestry Subcommittee

May 20, 2003

I want to thank you Chairman Gutknecht and other members of this subcommittee for asking me to testify and review the current state of the dairy industry. It's a privilege to testify before a subcommittee led by my representative, Chairman Gutknecht. His hometown of Rochester, Minn., is located near my family dairy.

For more than 80 years, members of the Rowekamp family have lived and milked cows in southeast Minnesota. I began helping my father Everett Rowekamp milk 28 cows in the late 1950s. When Dad retired in the 1980s, we were milking 100 cows. Today, my family is milking 235 cows with plans to build a new 2,500-cow dairy.

It's ironic that I am planning an expansion when milk prices are at a 25-year low. I am bullish, however, on an industry that has long been my family's livelihood and a Midwest stronghold.

The Midwest dairy industry has been struggling to maintain producers and infrastructure. I know firsthand the state is working to reinvent its industry. About 73 percent of Minnesota dairy producers recently surveyed by the Minnesota Department of Agriculture plan to maintain or increase herd size in the coming five years. This is good news after years of falling cow numbers and stagnating production levels.

This industry could turn around with help from agricultural leaders such as each of you. When taking steps to improve the dairy industry, I ask you to focus on the existing dairy price support system and the need to close milk protein trade loopholes.

Allow me to first examine the dairy farm income support program included in the 2002 Farm Bill. Quite frankly, the dairy price support system is not working. The farm bill calls for USDA to maintain a safety net of $9.90 per hundredweight. That has not happened. Class III prices have fallen below that level for eight of the last 10 months.

To maintain the price support system, dairy manufacturers sell surplus dairy products to the Commodity Credit Corporation at prices determined by the USDA. These prices should reflect the support price called for in the farm bill.

That system, however, has not been effective. For several weeks, commercial markets remained 5 cents per pound under CCC prices, indicating USDA-calculated product prices are too low.

To make the farm bill effective, I recommend two improvements. The first is asking the USDA to increase its purchase price for cheese, butter and nonfat dry milk to reflect the additional costs manufacturers face when selling products to the CCC.

The second improvement would be for the CCC to become an active trader on the Chicago Mercantile Exchange. The CCC could purchase products on the CME whenever the prices dip below the established CCC purchase prices. USDA could actively ensure the price levels called for in the farm bill.

In addition to price supports, the farm bill provides an additional safety net through the M-I-L-C payment. Without M-I-L-C payments, the rate of dairy farmer loss would be much higher. Though my farm's production has surpassed the annual M-I-L-C payment limit, I appreciate the positive effect it has had on fellow producers, our communities and the dairy infrastructure.

If USDA improves price supports as I have outlined, Minnesota dairy producers could be less dependent on M-I-L-C payments. Proper administration of the support program, however, would lower the M-I-L-C payments and generate more money from the market. That would be a win-win for dairy producers and taxpayers.

Let me also draw to your attention another win-win for dairy producers and their communities. In addition to milk, dairy farms could be generating electricity with anaerobic digesters that produce methane. This renewable fuel source powers generators. The energy bill should contain tax credits to encourage the production of this alternative energy source.

Finally, I ask each of you to renew your commitment to impose tariff-rate quotas on imported dairy proteins such as milk protein concentrate and casein.

Clearly, imports of milk protein concentrate are not the sole cause of the low dairy prices. They do, however, displace domestically produced nonfat dry milk that is purchased by USDA under the dairy price support program. This purchase then leads to a buildup of surplus dairy proteins.

When reviewing the 300 percent surge in dairy protein imports since the mid 1990s, it's clear to see how the import loophole has affected dairy producers in the past. But in many ways, the milk protein tariff legislation is about the future.

The MPC bill does not seek to stop all MPC imports. Rather, it brings consistency to the dairy tariff schedule so loopholes don't allow import surges that prevent our domestic dairy industry from recovering.

If milk markets recover, the U.S. dairy industry will grow even more vulnerable to MPC imports. Some U.S. manufacturers want to purchase cheap MPC from the world market before supporting their own domestic industry.

Chairman Gutknecht, effectively administering the existing dairy price support system, maintaining the M-I-L-C payments and imposing tariff-rate quotas on imported dairy proteins would move this industry forward. It would help the Rowekamp family continue to be southeast Minnesota dairy producers.

Statement by Constance E. Tipton

Executive Vice President

International Dairy Foods Association

Before the House Agriculture Subcommittee on

Department Operations, Oversight, Nutrition and Forestry

Tuesday, May 20, 2003

Mr. Chairman and members of the Subcommittee, I am Connie Tipton, Executive Vice President of the International Dairy Foods Association (IDFA), an organization that represents processors, manufacturers, distributors and marketers of fluid milk and milk products, cheeses, and ice cream and frozen desserts, as well as companies that supply ingredients, packaging and other services for the dairy foods industry. Our 450 members produce and process over 85 percent of the dairy products consumed in this country.

Thank you for the opportunity to participate in the discussion today about our nation's dairy industry. The long term prosperity of our dairy industry depends on sound policies that ensure the viability of domestic milk production and allow all segments of the industry to benefit from market opportunities. To meet these objectives sounds simple, however, outdated policies stand in the way of markets working most effectively and fixes to address short term farm price declines are keeping these objectives out of reach.

Typically, members of the Agriculture Committee focus on supply and price -- the level of milk production and how much is paid at the farm level -- but very little on product demand. We believe that each of these elements is critically important, they are interrelated and, in fact, interdependent. Companies that process and manufacture dairy beverages and foods depend on an adequate supply of milk and dairy ingredients, making them dependent upon healthy dairy farmers with sufficient income to ensure their farm businesses are viable. We believe we need better ways for farmers to manage price volatility so that farmers, both large and small, can weather monthly and seasonal price

swings. Likewise, to build product demand, dairy food and beverage companies must be able to take advantage of the abundance of new technologies for processing, ingredients, packaging and distribution. These technologies allow dairy companies to keep pace with the competition and drive new sales. It is therefore extremely important that we strive for policies that allow these critical elements to work well together and grow the market.

First, we share the concern about the dairy producers who are experiencing severe financial strain. The programs we have, in aggregate, are not accomplishing their goals, whether as a safety net for producers or to achieve orderly marketing. In fact, in many cases we believe these programs are the very cause of regional price distortions and extremely depressed farm milk prices. We need fundamental reform of current programs to provide a base for long term survival and indeed prosperity for dairy producers. What we do not need are more programs attempting to solve short term problems layered on programs that are the root of the problems.

I will discuss each of the current federal policies and how we see them relating to the elements of supply, farm price and product demand, then offer suggestions for future policy.

These multiple policies impact producers and processors with the many layers often having unintended and undesirable consequences. We believe it is extremely important for members of this subcommittee, in particular, to look at dairy policy with all of these programs in mind. Since seniority is a concept well understood here on Capitol Hill, I will briefly review the programs in chronological order, beginning with the most senior.

Federal Milk Marketing Order (FMMO) Program

This program is the dinosaur of dairy policies, having been put in place just after the Great Depression, nearly 70 years ago. The program's intent was good -- to assure consumers access to adequate and dependable supplies of high quality fluid milk and to promote orderly marketing conditions for dairy producers. In 1962, a blue ribbon committee, chaired by renowned economist Edwin G. Nourse, created a report for the Secretary of Agriculture on federal orders. Referred to as the Nourse Commission, the report included some of the best and most qualified thinking power on dairy policy of the time. Forty years later, we think its recommendations are largely on target and serve as excellent guidance for future policy. Unfortunately, over time, the principles of the FMMO program have been superceded by expediency, political power and the preservation of certain regional advantages.

The Nourse Commission listed six objectives for the Federal Milk Marketing Order program:

1. To promote orderly marketing conditions for farmers in the production of milk and thereby improve their income situation at least in the long run;
2. To administer and supervise the terms of trade in defined milk markets in such manner as to equalize the market power of buyers and sellers and attain

reasonable competition but not local monopoly resulting in undue price enhancement;

3. To assure consumers that they will have access to adequate and dependable supplies of high quality milk from the sources best suited both technologically and economically to supply these demands;
4. To complement the efforts of milk producers' organizations to maintain economic order in their industry, and to bring about the co-ordination of price structures and market practices within and between market areas, between fluid and manufacturing segments of the dairy industry and between milk production and other lines of farming;
5. To secure equitable treatment of all parties - producers, dealers, and consumers, not only within each local or regional market but throughout the system; and
6. To establish such terms of trade under the orders as will combine maximum freedom of trade with proper protection of established producers against seasonal or other loss of outlets that would tend to demoralize markets and farming plans.

Today, the FMMO program approaches the antithesis of these objectives. Milk marketing orders were conceived to provide a more orderly system for fluid milk so consumers would have fresh milk to drink. Other products were not considered. However, now about 74 percent of all milk produced in the United States is subject to minimum pricing set by federal orders, but only 38 percent of this milk is Class I, used for fluid milk. California produces over 20 percent of all of the milk in the U.S., and when its system is added with the federal order system, 90 percent of all milk produced in the U.S. is subject to regulated pricing. In California, only about 18 percent of the milk goes to Class I, fluid use. So today, by far the majority of all milk produced in the United States is regulated, but used for manufacturing purposes. This is a far cry from the original intent of federal orders to deliver fresh milk for drinking in every community.

The structure of the farm sector has also changed dramatically. When the Nourse Report was issued, there were about 1,400 dairy farmer cooperatives marketing about 60 percent of all U.S. milk. Today, three cooperatives market about 40 percent of all milk produced in the U.S., and about 200 cooperatives today market 83 percent of all milk. Clearly, market power has shifted to cooperatives and their dairy producer members.

Today, 8 percent of dairy farms produce almost 60 percent of the milk. These are farms with more than 200 cows, emblematic of a trend of farms growing larger and more efficient. In 2002, 380 farms had 2,000 or more cows, and those farms produced twice as much milk (25.5 billion pounds versus 12.9 billion pounds) than the 44,200 smallest farms that have fewer than 50 cows. There are now dairy herds in Indiana, Michigan and several other states with 20,000 cows. We have dairy plants that are served by a single farm operation. The producing segment of the industry is radically different than when the federal order program was put in place.[1]

Unfortunately, the federal order program has not kept pace with these enormous changes in the production sector. Instead of fostering access from production sources

[1] Attachments 1,2,3,4

best suited to supply various markets as recommended by the Nourse Report, order provisions have preserved advantages to local and regional groups of producers to the disadvantage of those outside the region.

There are seven areas of the country, including six federal order marketing areas and the state of California, where Class I sales are less than the national average of 33 percent. Three of these -- California, the Upper Midwest, and the Western Order -- have 20 percent or lower Class I use.[2] Many dairy economists believe that producer income in these areas would be higher without federal orders. Class I prices in the East and Southeast regions have actually had depressing effects on producer income in other areas of the country.

These regional distortions -- whether they are price enhancing or depressing -- should be eliminated. Technological advancements in refrigeration, transportation and distribution have completely changed the world; getting fresh products from farms to consumers over vast distances is now commonplace. There are now national brands of milk, as well as most other dairy products, that have national distribution and marketing.

Unfortunately, the evolution of the FMMO program through regulatory and legislative changes over 70 years, and particularly in the last two decades, has created a system of milk price regulation that often stands in the way of markets working and milk moving to its highest value use from the most efficient production areas.

Legislative attempts to use federal orders to achieve goals other than orderly marketing date to the 1985 Farm Bill, when Class I differentials were raised unequally across the country, solely to seal a political compromise that led to the Dairy Termination Program. The increases in the Class I differentials were greatest in the southeastern U.S., designed to offset fears that a higher proportion of dairy farms and milk production would exit that region via the Dairy Termination Program, not due to concerns about orderly marketing.

The 1996 Farm Bill took a different approach. Legislators, recognizing that the federal order system needed overhauling, assigned USDA the technically demanding task of deciding which regulations to change. However, after a three year process, during which USDA collected comments from the entire dairy industry before proposing changes, legislators bowed to political pressure and overturned some, but not all of the changes proposed by USDA.

Leaving some changes in place, while mandating status quo for other regulations resulted in an even larger distortion in regional farm milk price relationships in 2000 than had ever occurred previously. This was due to the combination of two changes: a mandate to disregard USDA's proposed changes to decrease Class I differentials in most areas of the country, and a new, higher base price for calculating Class I prices. These changes significantly increased Class I prices because the higher Class I differentials

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[2] Attachment 5

were added to a higher base. This greatly benefited high Class I use areas and further depressed prices in areas with high manufacturing milk uses.

Classified pricing is at the root of many of the industry's problems. Federal orders set and enforce minimum prices that are paid by processors and manufacturers to cooperatives and independent dairy producers according to how that farm milk is used. Producers in a federal order area are paid an average or blend price based on a weighted averaged combination of the class prices paid in their area. Under federal order classified pricing, the highest minimum price is set for Class I milk used for beverage consumption, and successively lower minimum prices are set for Class II (yogurt, ice cream, soft products), Class III (cheese), and Class IV (butter and dry milk products.) As a result, an area such as Florida with a higher percentage of Class I milk use (89 percent Class I) will have a greater dollar value to share among its producers. Conversely, areas such as the Central, Upper Midwest and Western orders where there is a much greater percentage of the milk production going into cheese, gain little from the higher Class I price. Due to greater milk production in the high Class I price areas, those areas with lower Class I use realize further declines in manufacturing milk prices. As just discussed, these differences were exacerbated by changes made in the Federal Milk Marketing Order program as a result of the 1996 Farm Bill which both increased the minimum base price used to calculate the Class I milk price and maintained the status quo regional differential paid on top of that base.

Despite this onerous regulatory pricing scheme, fluid milk companies have become new pioneers in the world of product innovation and marketing, offering new, exciting single serve options for consumers in an array of distribution channels where milk was not available previously such as in vending machines and in food service. Efforts are also being made to better market new and exciting products in schools. Millions of dollars have been invested to enliven the fluid milk market. While there are some recent bright spots in building consumption among our nation's teenagers, per capita consumption of fluid milks continues its long-term downward trend. Our dairy policies need to be revamped to better enable milk to compete in an increasingly crowded beverage market, which today includes new dairy-based drinks along with carbonated soft drinks, juice and sport drinks, and even fortified waters aimed at stealing away the teen market where the real beverage battle is taking place.

It is exciting that traditional milk companies are fighting for increased sales. But new products like Raging Cow, a dairy-based beverage manufactured by a soft drink company, sends a warning signal that the time has come to level the playing field by pulling back on enormous price discrimination against fluid milk companies who must pay high Class I prices. New products like Raging Cow have lower milk solids content, and as a result, their manufacturers can buy that farm milk at a lower, Class II price. Regulations should be revamped to allow milk to compete on a more equal footing with the increasing number of beverage options. It is our strong belief that creating more product demand, through better pricing, packaging and product variety, is the long-term solution for our industry.

Cheese has been a prime example of what can be done to drive overall dairy demand with the right combination of affordable ingredients, creativity, technology and marketing. Cheese has been the leader for the past several years in driving dairy demand through new product offerings like shredded cheeses that provide convenience for greater at home use or stuffed crust pizza for increased cheese use away from home. Cheese use over two decades has doubled to more than 30 pounds per capita, but this rapid growth may have peaked. Last year, demand for cheese was down for the first time in over 18 years. Unfortunately, this lag in demand has contributed to our current supply and demand imbalance.[3]

With respect to the federal order system and addressing its flaws, we are looking at ways to simplify the program so that it once again delivers orderly marketing and fair pricing to farmers across all regions, at the same time, allowing milk to move where the market demand exists, rather than locking it in to set uses based on outdated federal order classifications and manufacturing cost allowances. We believe this is best done through the regulatory process so that program complexities can be examined and addressed in a less politically-motivated environment. We firmly believe the decisions for the future must be made based not only on orderly marketing today, but on building markets for the future -- supply, price and demand must all be considered for the dairy industry to survive and thrive.

Dairy Price Support Program (DPSP)

This program was put into place in 1949 to provide a safety net under farm milk prices. It has evolved over time, but in a somewhat more progressive direction than the federal order program. Originally, dairy price supports were based on the concept of parity, which required changes in the farm milk support level to maintain the same relationship between milk prices and farm input costs which existed during the so-called golden age of agriculture, 1910 - 1914. Unfortunately, the concept of parity as applied to agriculture ignored productivity changes; for instance, use of this formula did not take into account increases in output per cow (from 3,120 pounds per year average during 1914-19 to 18,570 in 2002), nor increases in the average number of cows per farm or any other measure of increases in farm productivity. For example, a current farm milk price based on the concept of 100 percent of parity would be over $30.00 per hundredweight. Policies and programs that rely on a fixed benchmark that ignore productivity advances based on applications of management and production technologies are flawed and unsustainable.

This was clearly seen in the early 1980s, as government stocks of dairy products grew so large there was no longer available storage, and costs to the taxpayers rose to more than $2 billion annually to buy the surplus product. As pressure mounted to bring the program more in line with markets, Congress gradually decreased the dairy price support level over time, markets strengthened as government stocks declined, and producer income rose steadily.[4]

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[3] Attachment 6,7,8
[4] Attachment 9

Then, in the 1996 Farm Bill, there was agreement across the industry to phase out the Dairy Price Support Program by December 31, 1999, with a non-recourse loan program authorized to provide an ongoing safety net. Instead, legislators extended the program several times until the 2002 Farm Bill, when the DPSP was permanently reinstated and the non-recourse loan program deleted. This has created new problems for the dairy markets.

The first problem is the enormous amount of nonfat dry milk purchased by USDA in recent years. This has created a literal mountain of government-owned nonfat dry milk, and forced USDA to create new market distorting mechanisms to dispose of this surplus. These new nonfat dry milk disposal programs have done little to reduce the stocks, both because the industry has little use for many of these programs and due to the fact that USDA continues to purchase millions of pounds of nonfat dry milk each week. However, these programs have created havoc in the dairy markets, where surplus nonfat dry milk competes with current production of nonfat dry milk, as well as with many whey products. Compared to summer 2001, the price of dry whey is down more than 45 percent.

This program in recent years has also created enormous distortions in regional farm milk prices due to changes in federal order regulations made during the reform mandated in the 1996 Farm Bill. Government purchases of nonfat dry milk increased significantly beginning in the late 1990s, with nearly tenfold increase from 58 million pounds in 1996 to 541 million pounds in 1999. At the same time, there were no purchases under the DPSP of any other dairy product; a clear signal that the program was not adjusting to market conditions.

This problem reached new heights in 2000, when the government removed 47 percent of all nonfat dry milk produced in the United States that year. However, under the price regulations of the federal order program, the minimum price required to be paid to dairy farmers for milk used in nonfat dry milk and butter, known as Class IV use, was $11.83, far above the stated dairy support level of $9.90. This resulted from the higher than market level CCC purchase price for nonfat dry milk coupled with the high market price for butter. The market price of butter that year, at $1.14 per pound, averaged 75 percent above the DPSP butter purchase price of 65 cents per pound.

Unfortunately, the market distortions did not stop at just supporting farm milk prices at nearly $2.00 per hundredweight above the safety net level set by Congress. Federal order reforms, which we have already discussed, changed the base price to which the Class I differentials were added to calculate the minimum Class I milk price. The new regulations required the use of the higher of the Class III or Class IV price formula. In 2000, the Class IV price averaged $1.70 per hundredweight higher than the Class III price and this was largely driven to that higher level by the operation of the price support program that kept nonfat dry milk prices higher at the same time butter prices were soaring. This contributed, once again, to regional farm milk price distortions.

In June 2001, USDA adjusted the purchase prices for nonfat dry milk and butter under the Dairy Price Support Program, but even this adjustment was not enough to bring the program fully inline with market conditions, and another so-called "tilt" adjustment was announced in November 2002. In the first four months of 2003, the Class IV minimum milk price has averaged only 36 cents higher than the Class III price.

Through the DPSP, the government has encouraged continued production of nonfat dry milk for which there was no market demand, instead of allowing market demand for high protein dairy ingredients which are increasingly used in new food products and product formulations to drive production of these products. The economics were clear; it was profitable to continue producing nonfat dry milk and sell it to the government, and no incentive existed to retool and produce other new products.[5]

There are assertions that the current low milk prices are the result of imported milk protein concentrates (MPC), casein and caseinates. This simply is not accurate. While imports have grown in the last ten years, imports of these products actually declined by more than 20 percent between 2000 and 2001, and further declined in 2002. Current low milk price levels are the direct result of soaring milk production and lagging demand for dairy products. Both are partly the result of too many government programs that encourage more milk production and put dairy products at a competitive disadvantage in the marketplace.

Recently, proposals have been advanced to subsidize the domestic production of MPC, casein and caseinates. USDA has been running a pilot program to subsidize the production of casein from its surplus stocks of nonfat dry milk, yet there has been very little interest in the program, in spite of the fact that some of the subsidies have been quite large, as high as 50 to 60 cents per pound. We would like to see a domestic industry developed and are watching with interest the joint venture between Fonterra, the largest New Zealand dairy co-op, and Dairy Farmers of America to produce MPC in New Mexico. This joint venture is being undertaken with no government subsidies which suggest that the increasing demand for these products will provide sufficient stimulus to create a domestic industry. Existing federal dairy programs have created inefficient distortions in dairy markets and the record suggests that another program would compound these inefficiencies. Finally, we believe that a new domestic subsidy program to create MPC would have very significant World Trade Organization trade problems similar to the trade dispute that erupted in the 1980s when the European Union threatened to subsidize its production of soybeans undermining our access to that market.

The subsidies for nonfat dry milk under the Dairy Price Support Program are the real reason domestic production of MPC, casein and caseinates has not occurred. The DPSP has maintained nonfat dry milk prices well above world market levels, encouraging production of nonfat dry milk for sale to the government rather than investing in facilities to produce these high protein dairy ingredients demanded by the marketplace.

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[5] Attachment 10

MPC, casein and caseinates are unique ingredients that can be manufactured to any specific protein level. There are also many other benefits of using these proteins in food processing whether it be for taste, form, texture, color, consistency, flavor, stability, digestibility, spreadability, emulsification or versatility.

For example, the nondairy creamer you pour into your coffee likely contains sodium caseinate, which is perfect for this food application because it is soluble in water. Sodium caseinate also enhances the taste and provides the whitening properties to lighten your coffee to just the way you like.

The very low levels of lactose in casein make it an ideal ingredient for products that need to be tailored to a specific use, such as lactose- or sugar-free. A good example is hypoallergenic baby formula that requires protein, but not lactose.

And, unlike nonfat dry milk, which contains lactose, MPC is easily formulated to meet specific product requirements in the rapidly-growing sports and nutritional beverage and food market. For example, nutrition energy bars, which are very popular with fitness-minded individuals, contain high protein levels, but little or no fat or lactose.

Despite the strong appeal of MPC, casein and caseinates to manufacturers, some in the dairy industry would like to see imports curtailed through higher tariffs. When we recognize the essential contribution these ingredients make to food product development and that they can create new demand for dairy overall, it is clear that the U.S. dairy industry needs to support the use of competitively priced milk protein ingredients.

Dairy Export Incentive Program (DEIP)

The Dairy Export Incentive Program was created in the 1985 Farm Bill to make the U.S. dairy industry competitive with subsidized exports from other countries, but in particular the European Union. The U.S. dairy industry had developed a significant export market when support prices were maintained at market clearing levels. Subsequently, the European Union began to provide export subsidies in a variety of ways and made U.S. produced products less competitive. Additionally, U.S. prices were more volatile and therefore the U.S. was only a competitive supplier to the world market intermittently. With the U.S. export subsidy, dairy products could be more competitive on a regular basis.

Although the law requires the Secretary to give consideration to the impact of using DEIP exports on the domestic market, its use has nevertheless driven up domestic commodity prices by a significant amount on several occasions. For instance, over 40 million pounds of butter was exported under DEIP in the second half of 1997 creating a severe shortage in our domestic market in the summer and fall of 1998 forcing much higher prices for many products using high butterfat ingredients such as ice cream. It is important that these government interventions be managed to achieve their export market goals without adding significant distortions in domestic markets.

Other Programs Available for Dairy Producers

In addition to the three, long-standing federal dairy programs just discussed, the 2002 Farm Bill created three new USDA programs available to dairy producers to augment their income and expanded another existing program. The three new programs are the Milk Income Loss Contract (MILC) to provide direct payments when milk prices are below a certain level; the Livestock Compensation Program (LCP) put in place to provide drought relief; and the Environmental Quality Incentives Program (EQIP) offering assistance for compliance with environmental goals. In addition, the Agricultural Management Assistance (AMA) program which provides assistance for a variety of activities related to farm management was expanded. A producer eligible for all of these programs could receive a substantial benefit, for instance, a dairy producer with 144 cows could increase total income by nearly 15 percent.

It should be noted that these programs are concerned specifically with milk producing operations. Additional programs are targeted to crop production. Assistance related to crops produced for feed certainly applies to a dairy farm, but is not included in this review.

Milk Income Loss Contract (MILC)

This program pays a producer 45 percent of the difference between $16.94 and the monthly Class I price in Boston. The object is to pay farmers more money for milk when prices are "too low." Farmers can receive payment only on the first 2.4 million pounds produced in a fiscal year, once the farmer has signed up.

The program pertains to milk production since December 2001. The time from December 1, 2001 to September 30, 2002 is called a "Transition Period" and corresponding disbursements were considered "Transition Payments." Afterward, the timeline is based on the USDA's fiscal calendar with "Program" periods and payments.

Because the MILC payment is based on monthly differences and because those differences were smaller in the initial months, the payment a farm received varied by farm output and/or sign-up month. The most money a farm could receive based on milk sales in each from December 2001 through September 2002 (a small farm) would be $25,968. A farm shipping approximately 1.3 million pounds or more per month would only want to be paid on production in September, because the payment would be greatest and could mean receiving as much as $34,800 if the limit of 2.4 million pounds was shipped in that one month.

If any such producers also signed up for fiscal year 2003 they received $1.59/cwt. for milk shipped in October (again subject to the cap of 2.4 million pounds.) This means that same large operation that was only paid for September (Transition Payment) would also get a 2003 program payment of $38,160 for October, making the grand total of $72,960 received for calendar year 2002 for the MILC alone.

While this payment program has been extremely helpful to many dairy producers in making it through a low price period, most agree that it has, in fact, contributed to keeping prices low rather than allowing a normal recovery to occur. We know from many years of history that more money means more milk, and when milk supplies exceed demand, prices go down and stay down. Some form of payment program may be the best idea for a long term safety net, but we must first peel away some of the program layers. The DPSP, FMMO classified pricing and MILC payments are a dangerous combination and they are clearly not working for the benefit of producers.

Livestock Compensation Program (LCP)

This program paid $31.50 per dairy cow and $13.50 per stocker (replacement animal weighing a minimum of 500 lbs.) to farms in states or counties designated as a primary drought disaster area for either of the 2001 or 2002 droughts. The payment subsidized the additional feed costs incurred by low yields and resulting higher feed prices. Producers were limited to compensation of no more than $40,000 and could only receive these payments if their gross income (inclusive of this and any other government program money) was less than $2.5 million dollars.

Because government program money counts towards the gross income limit, this has implications for the layering of government money to certain sized farms. To get the $40,000 means having either a milking-herd size of 1,270, or a cow plus replacements (40 percent) total of 1084. But herds of these sizes, with a herd production average of 20,000 per year, would have passed the gross income constraint before reaching the $40,000 payment limit. Using the all-milk price from 2002, it took only 1,031 milking cows to reach the gross income limit.

In the 2002 Farm Bill, some or all of the counties in the following states were included in LCP: AZ, CA, CO, GA, HI, ID, IN, IA, KS, KY, LA, ME, MI, MO, MT, NE, NV, NM, NY, NC, ND, OH, OK, OR, PA, SC, TN, TX, UT, VT, WA and WY. The recently passed Agricultural Assistance Act of 2003, among other actions, expanded this list to include at least one county in every state. The 2003 Act also created the Livestock Assistance Program (LAP) to reimburse livestock producers for grazing losses that may not be covered by the LCP. While more farms across a greater portion of the U.S. are covered by these programs, the total receipts from LCP and/or LAP remain limited to $40,000 per farm.

Environmental Quality Incentive Program (EQIP)

This program encourages farmers to become better environmental stewards, and provides cost-share money to buy the necessary improvements or equipment. Total payments are limited to $450,000 per farm over the life of the farm bill, not to exceed 75 percent of the costs involved (except in cases of some resource limited or beginning farms.) With a 5 year life of the Farm Bill, this means an average annual limit of $90,000. EQIP is also subject to the $2.5 million cap on gross income, but this time it is the average adjusted gross income (AGI) over the last three years, and doesn't affect the

farm if 75 percent or more of the farm's AGI comes from farming, ranching, or forestry interests.

Receiving this money is much more complicated than providing proof of damage to the local FSA office. A full proposal outlining the practices to be adopted and the costs involved must be approved by the local conservation district. The proposals are scored against a set of state and locally determined criteria.

Agricultural Management Assistance (AMA)

This assistance will help farmers in selected states of the northeast and west with improvements ranging from reducing adverse environmental impacts to encouraging the use of risk management tools. These include watershed management, irrigation, windbreaks, production and /or marketing diversification, and various forms of hedging, for price, revenue, and/or production. Payments are limited to $50,000 per year per farm and there does not appear to be a limit on gross income. The only states where this applies are CT, DE, MD, MA, ME, NV, NH, NJ, NY, PA, RI, UT, VT, WV and WY.

Dairy and Trade Policy

New markets hold the key to long term success, and export markets are an important part of the opportunity for dairy. Today, dairy exports account for only about 5 percent of U.S. milk production, but on a total milk solids basis, exports amounted to 1.067 billion pounds in 2002, while imports were 852 million pounds on a total milk solids basis -- about 80 percent of the level of exports. Interestingly, one of our most successful export products is whey, a by-product of cheesemaking and a dairy product that is outside of the many domestic government regulatory programs and trade policies. The "free market" status of whey has enabled that industry to be innovative and create valuable dairy ingredients, with particular growth in Asia, where dairy production is not abundant. About 25 percent of the dry whey products produced in the U.S. is exported to overseas customers.

To realize our potential in trade, it is especially important that we vigorously pursue inclusion of agriculture trade goals in the Doha Trade Round. For dairy, we must have the elimination of export subsidies, particularly by the European Union, better market access and meaningful reduction of trade-distorting domestic supports that level the international playing field in order to reach our real potential as a supplier of dairy ingredients and products around the globe.

New Directions for Dairy Policy

We believe it is enormously important for this Committee to carefully consider any changes to existing dairy policy or future dairy policies with a clear understanding of all of these programs and how they interrelate. We strongly support providing assistance for farm investments that will help the environment or contribute to responsible land conservation. We believe there should be a single, national program to provide a safety

net for dairy farmers that is as little market distorting as possible, yet still provides critical assistance when it is needed. And, finally, we think the time has come to make some reforms in federal order classified pricing to allow market demand to play a larger role in moving milk to its highest value use. This could reduce regional differences and bring better alignment between the federal system and California.

Interstate Dairy Compacts

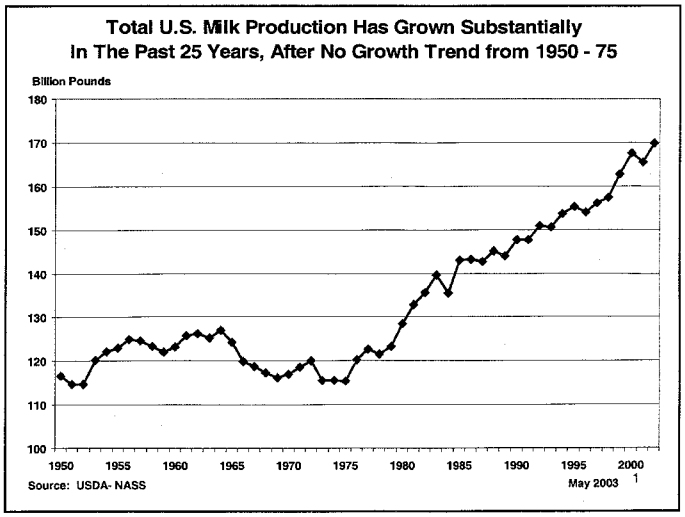
There are always suggestions for more programs; more "solutions," but one that should be quickly rejected is the idea of putting in place new interstate dairy compacts to prop up prices. We believe that dairy compacts are not the answer -- they will only confound markets and drive regional differences.

The Northeast Interstate Dairy Compact set Class I milk prices (milk used for beverage milks) at a level higher than that normally achieved under the federal order pricing, so that there was a premium each month calculated between mandated federal pricing and the Compact price. In high Class I use markets, these premiums would occur on a higher percentage of the milk than in low Class I use markets, further compounding the differences between producer payments between regions.

The market for milk and dairy foods is no longer a local or even regional market. In many cases, farm milk as well as consumer products move substantial distances across regions. Because of this, it is essential that we have a national policy that lessens distortions rather than creating new layers of regional policies that are difficult to coordinate and interfere with efficient marketing.

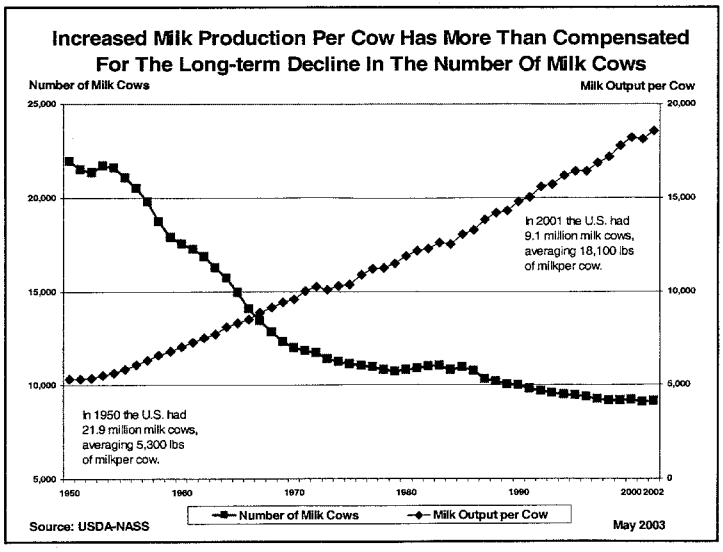
Mr. Chairman and members of the Subcommittee, our organization is committed to working toward a policy environment that allows our U.S. dairy industry to prosper at all levels and we stand ready to provide any input and assistance that would be helpful to achieve success. Thank you.

Attachment 1



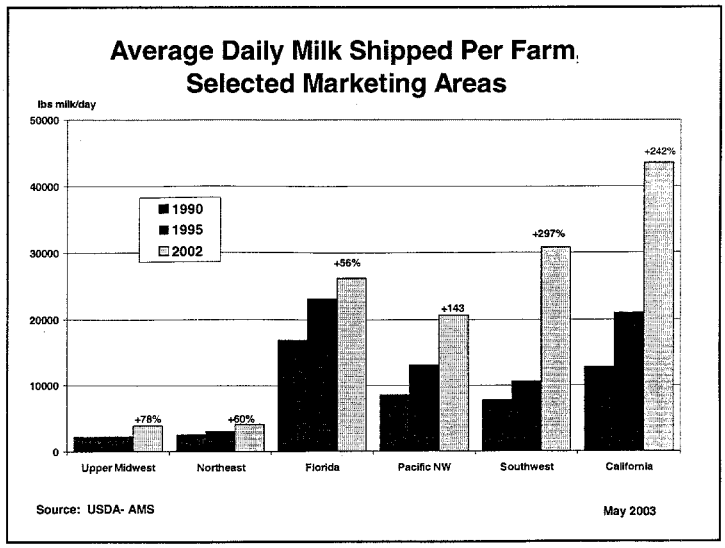
- Total U.S. milk production increased 2.6% in 2002 from the 2001 level. This was 2 billion pounds greater than the previous record in 2000.
- Milk production in 2003 continues the growth trend, up another 1.3% year-to-date (March).
- Improvements in dairy production technologies, including genetics, breeding, feeding, cow comfort, and farm management have contributed to a general increase in production since the mid 1970's.

Attachment 2



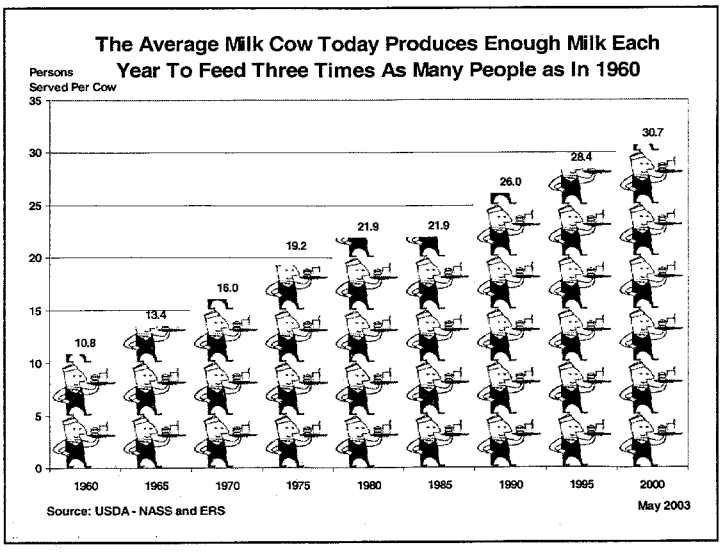
- The total number of dairy cows in the U.S. has been declining for decades. The average annual rate of decline for the past 50 years has been 1.7%.
- Cows are increasingly more productive. Since 1975, the average milk output per cow is up more than 75%.
- On balance, the increase in per cow productivity has more than offset the decline in the number of milk cows - total U.S. milk production has increased 47% since 1975.

Attachment 3



- Whole farm output has been rising across the country, but has shown the most growth in California and the Southwest.
- Increased production per cow has been a contributing factor in greater production per farm. Equally important have been technological advances that allow larger herd sizes. These improvements have been adopted more readily in California and the Southwest.

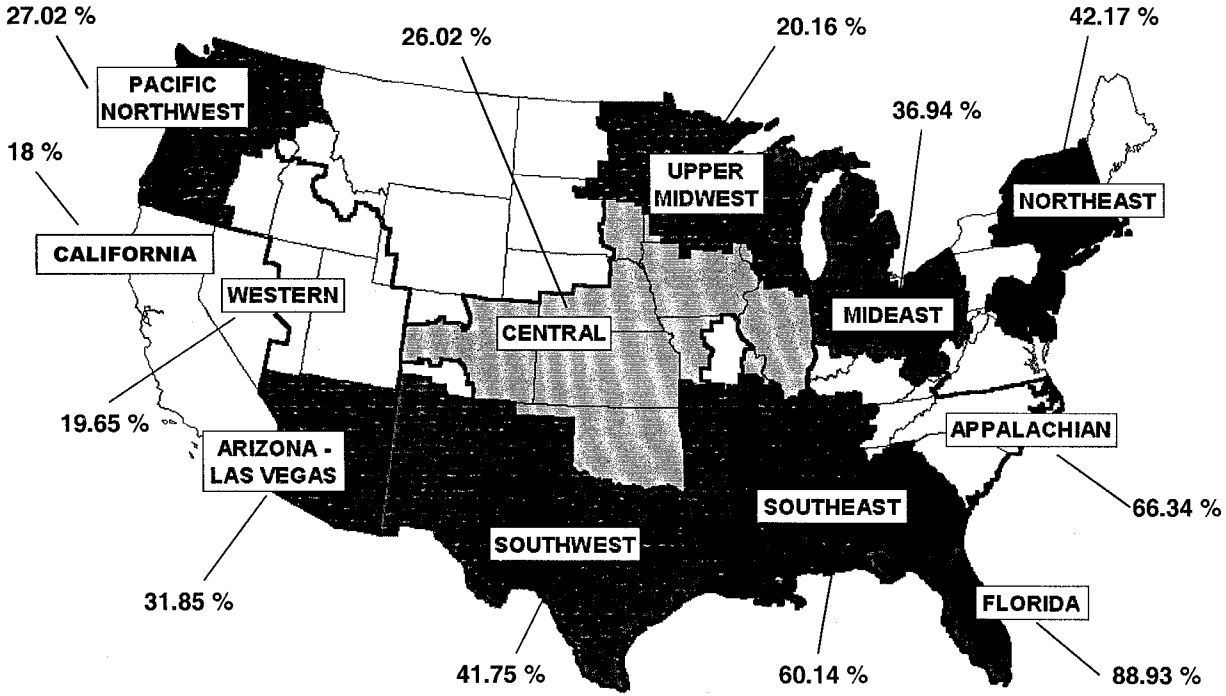
Attachment 4



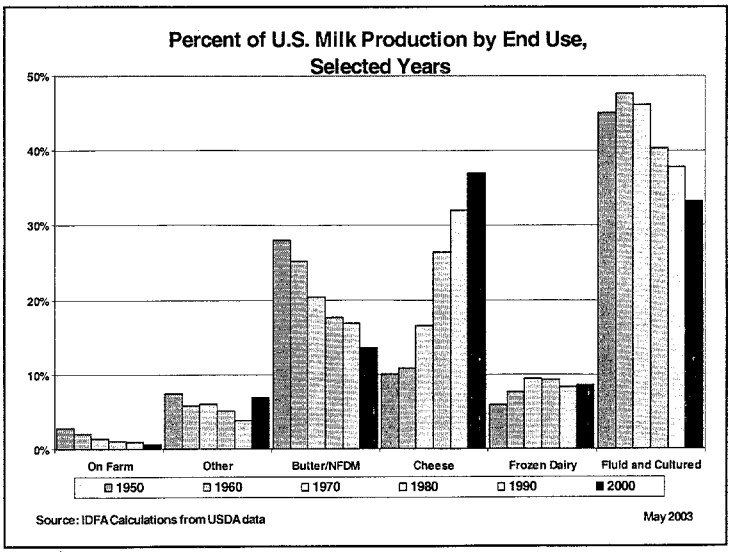
- Per cow production has been increasing for many years. However, consumption of dairy products has not increased as fast. The result is that one cow produced enough milk in 2000 to fulfill the needs of more than thirty people.

Attachment 5

2002 Average Class I Use for Federal Milk Order Marketing Areas and California

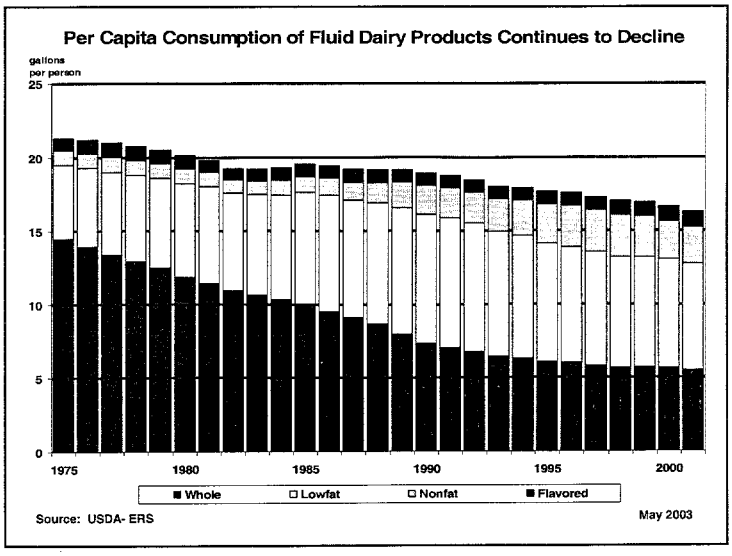


Attachment 6



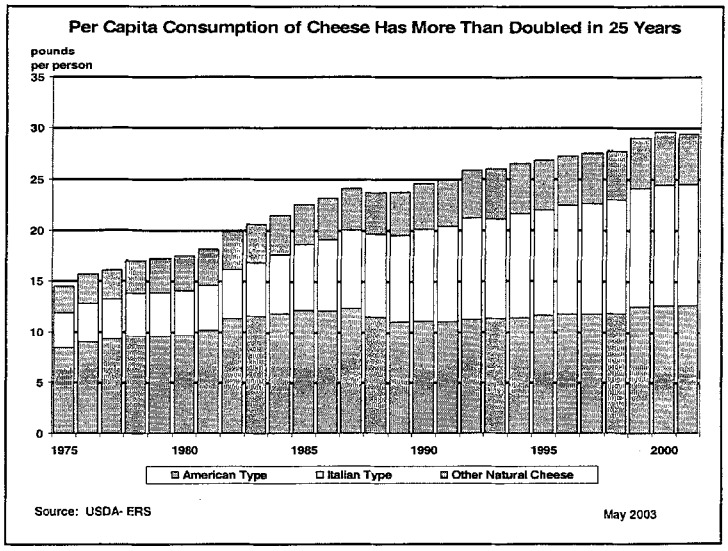
- Over the past 50 years, the demand for dairy products made from milk has changed dramatically.
- The percentage of US milk production used to make butter and nonfat dry milk has declined, as has the percentage of milk which ends up in fluid dairy products.
- Meanwhile, the percentage of milk used to make cheese today is nearly four times that of 50 years ago; cheese is the only use of milk to consistently grow during that time.

Attachment 7



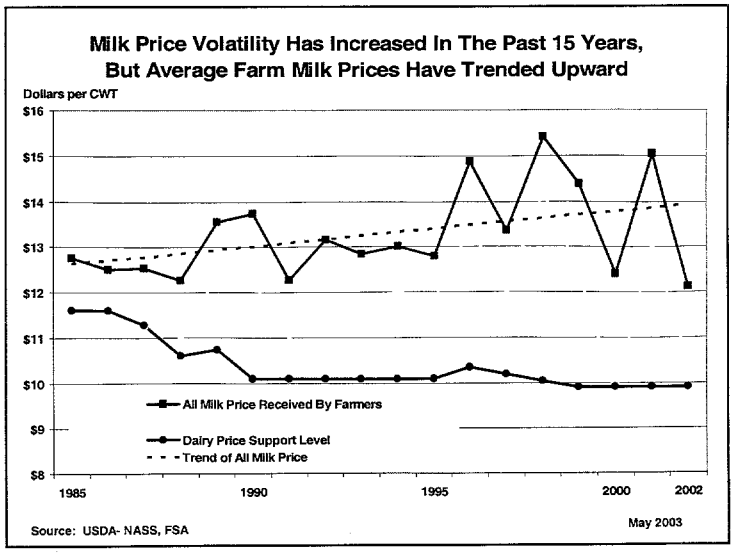
- Per capita sales of fluid milk products have declined by over 23% since 1975.
- Whole, white fluid milk has declined the most, down over 60% during the past 25 years.
- After peaking in 1991, per capita consumption of lowfat fluid milks have declined by more than 17%.
- Nonfat fluid milk per capita sales showed strong growth for about 15 years ending in 1997, but since then have fallen off.
- After years of no trend, per capita sales of flavored milks have grown by 30% in the past

Attachment 8



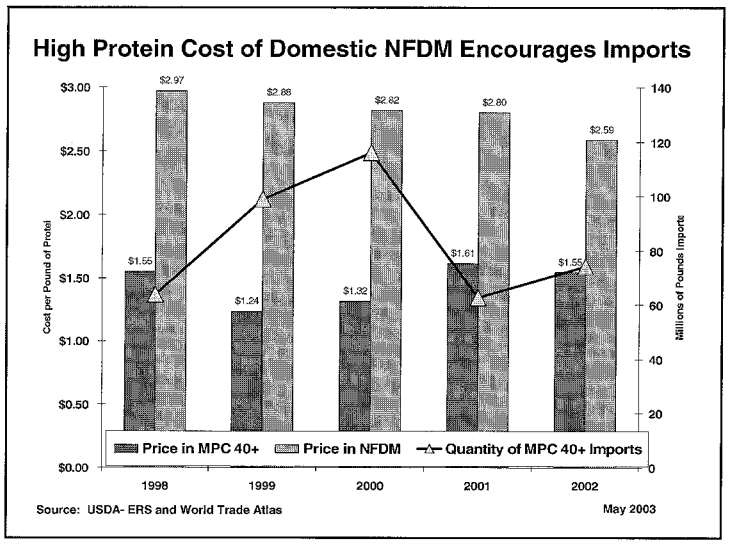
- Per capita consumption of cheese has been the driver pushing demand for milk.
- By far, Italian style cheeses have led the charge, with per capita consumption today more than 2.5 times that seen in 1975.
- During the same period, per capita sales of American style cheese has grown by more than 50%, and other natural cheese types have seen per capita sales double.

Attachment 9



- Dairy price support levels were reduced in the 1980's to curtail mounting government purchases of surplus dairy products. Price volatility has increased, but average farm milk prices have trended upward.
- The farm milk price over the last five years averaged $13.87 per hundredweight (cwt.).
- In fact, four highest farm milk price years on record (all averaging above $14 per cwt.) occurred within the past seven years.

Attachment 10



- Milk Protein Concentrate (MPC) is an example of a technological advance in milk processing. After water, butterfat, and some non-fat solids are separated from farm milk, the concentration of protein is greatly increased. This new product has wide applicability in food processing.
- Protein from MPC is favorable for two reasons. First, the concentration can be specified by contract, improving uniformity to meet formulation requirements. Second, under domestic pricing regulations, an equivalent volume of protein has been cheaper in MPC than in domestic NFDM.

IDFA comments on the graphics introduced by National Milk Producers Federation during the U.S. House of Representatives Committee on Agriculture Subcommittee on Department Operations, Oversight, Nutrition and Forestry held on May 20, 2003.

CHART NO. 1—12 MONTHS OF MILK PRICES

Comparing class prices under Federal Milk Marketing Order regulation with the support price established under the Dairy Price Support Program is not a valid comparison. The class III price for milk used to manufacture cheese products is a minimum price which processors must pay to dairy producers and cooperatives, and in no way indicates the actual amount paid for such milk. In addition, Federal Order minimum prices are stated for milk at a standard butterfat content of only 3.5 percent.

On the other hand, the legislative mandate to the Department under the Dairy Price Support Program directs the Department to insure that the average price paid to dairy producers for milk used in all manufactured dairy products be at least $9.90 per hundredweight. In addition, this $9.90 is for milk testing 3.67 percent butterfat.

The only farm milk price series available to estimate the average price paid to dairy producers for milk used in manufactured dairy products is the manufacturing grade milk price series published by the National Agricultural Statistics Service in the monthly Agricultural Prices report. Since 1985, the annual average price of manufacturing grade milk, as published by USDA, has never been lower than $10.38 per hundredweight adjusted to 3.67 percent butterfat. For the most recent 12-month period (May 2002 through April 2003), the average price paid for manufacturing grade milk, adjusted to 3.67 percent butterfat, was $10.15 per hundredweight.

CHART NO. 2—CUMULATIVE PRODUCER LOSSES FROM USDA'S TILTS, AND CHART NO. 2B—CUMULATIVE ADDITIONAL COST TO CCC DUE TO NOVEMBER 2002 PRICE SUPPORT TILT

As every witness appearing before the Subcommittee testified, the low milk prices currently experienced in the dairy industry are the result of many factors, but the key factor had been the high milk prices on average during the previous five years, coupled with strong demand growth for milk and dairy products. The current situation is the result of milk production growth far outpacing the growth in demand for milk in dairy products, a fact of the dairy markets. IDFA believes that it is critically important for USDA to operative the Dairy Price Support Program to maintain alignment between the actual market prices for dairy products and CCC purchase prices.

CHART NO. 3—DEIP AWARDS FOR BUTTERFAT AND BUTTER PRICES

IDFA believes that USDA must carefully consider the potential impact on our domestic dairy markets prior to accepting bids under the Dairy Export Incentive Program. As this chart clearly shows, the domestic market price of butter increased following the late February announcement by USDA of an additional allocation for butterfat under this program. Two other key market data not on this chart are the fact that the world market price for butter during the time of the DEIP bid acceptances was about 60 cents per pound (about 45 to 50 cents per pound less than the CME price), while the average DEIP bonus awarded by USDA was over 70 cents per pound of butter equivalent.

CHART NO. 4—MILC PAYOUT FOR TRANSITION YEAR

IDFA has taken no position on the administrative details of the Milk Income Loss Contract program payments for the transition year.

CHART NO. 5—U.S. MILK PROTEIN CONCENTRATE AND CASEIN IMPORTS

As this chart clearly shows, the total volume of imports of these products has declined significantly in the past two years from the peak level seen in calendar year 2000. What the chart does not show, and IDFA believes is very important for the Subcommittee to note, is that dairy exports account for about 5 percent of U.S. milk production. In addition, in comparing our volume of total dairy exports to the volume of imports, on a total milk solids basis exports amounted to 1.067 billion pounds in 2002, while imports were only 852 million pounds on a total milk solids basis—about 80 percent of the level of exports.

CHART NO. 6—ALL-MILK PRICE, 2001–03

Similar to charts 2A and 2B, this appears to imply that recent low milk prices are the result of actions taken by USDA to adjust the CCC purchase prices of nonfat dry milk and butter. In fact, the current situation is the result of milk production growth far outpacing the growth in demand for milk in dairy products. IDFA believes that it is critically important for USDA to operative the Dairy Price Support Program to maintain alignment between the actual market prices for dairy products and CCC purchase prices.

AMERICAN DAIRYMEN'S FEDERATION

May 30, 2003

The Honorable Gil Gutknecht
Chair
Subcommittee on Department Operations, Oversight, Nutrition, and Forestry
U.S. House Agriculture Committee
Washington, D.C. 20515

Dear Chairman Gutknecht:

The American Dairymen's Federation is made up of many regional producer trade associations that have joined together across the United States to form one unified voice for the American dairy producer. This new federation actually has many combined years of experience and knowledge about the issues facing the second largest farm industry in the United States. Membership is coast to coast with producer members milking 30 cows to 3,000 cows.

The American Dairymen's Federation appreciates the opportunity to respond to the May 20th dairy hearing. Perhaps in the future our dairymen may have the opportunity to offer some light on the many contentious issues facing today's dairy families.

Due to the lack of enough clarity on the issue of imports this letter will focus the attention to that rather than blame USDA as the problem of our industry. On the day before the hearing a study released by the Sparks Companies Inc. concluded "sharp increases in milk production and weak dairy product demand" rather than imported milk proteins have caused recent milk price declines. Large multinational firms funded this study many are foreign in origin and who call themselves the US Coalition of Nutritional Ingredients.

The domestic balance of markets and milk production for the past eight years shows 2.4% less production as compared to the commercial disappearance.

The study plays down the quality of nonfat dry milk as a commodity with lower protein content and less functionality. The truth of the matter is quite the opposite when wholesomeness and quality of these proteins are compared to unadulterated nonfat dry milk. Nonfat dry milk is the complete product with all of the minerals and elements that are included in whey that has become such a nutritional ingredient and even has been fractionated for use in medicinal products. The only element missing from nonfat dry milk is the fat that was used to make butter. Casein and casein derivatives products such as MPC have either been chemically extracted or ultra filtered from skim milk. This processing removes most or all of the properties from the nutritious skim milk except the protein.

AMERICAN DAIRYMEN'S FEDERATION

The Unites States and European countries do not allow those casein and casein derivative products such as MPC to be included in the definition of milk for all standardized cheeses.

The report criticizes the United States for not producing these concentrated milk protein products, however the facts need to be presented why this country has not produced those so-called "preferred" concentrated milk protein products. The European Union countries produce 10% more milk than they consume. This imbalance of market conditions are complicated by a taxpayer dumping scheme to clear those markets. This export subsidy lowers all of the prices for products that are traded in the world. The subsidy for powder was recently increased by the EU in direct response to the tilt the Secretary implemented on November 15, 2002.

As the United States became a net importer of dairy products in the mid 90's the processing industry discovered that there was a product similar to nonfat dry milk heavily subsidized by foreign governments and since there was no domestic production of these ingredients that were traditionally were used in paints and glues had little or no tariffs.

It seems quite odd that 42% of all dairy imports are coming into the US from the EU, when the producers of the EU actually receive milk prices significantly higher than in the US.

Producers in the United States have been faced with prices below cost of production for 18 months. This financial catastrophe is spreading to many associated supply and support industries in the dairy communities of America.

The inequities of these global conditions are beyond the ability of any American dairy producer to be able to adjust to. The time has come for Congressional leaders to examine and un-bias determine what the truth is in order to develop fair policy for all of the people of America.

On behalf of the 10,000 dairy families represented by the American Dairymen's Federation we thank you for your attention on these matters.

Sincerely,

Joaquin Contente

Joaquin Contente, President
American Dairymen's Federation

CALIFORNIA DAIRY CAMPAIGN
"DAIRYMEN WORKING FOR DAIRYMEN"

May 27, 2003

The Honorable Gil Gutknecht
Chair
Subcommittee on Department Operations, Oversight, Nutrition, and Forestry
U.S. House Agriculture Committee
Washington, D.C. 20515

Dear Chairman Gutknecht:

On behalf of the more than 450 dairy farmer members of the California Farmers Union (CFU) and the California Dairy Campaign (CDC), we submit the following testimony for the May 20 hearing held by the Subcommittee on Department Operations, Oversight, Nutrition, and Forestry on the "State of the Dairy Industry."

We do not believe that the testimony of the witnesses, particularly the dairy producer witnesses, is representative of the viewpoints of the dairy farmers we represent or the dairy farmers we work in coalition with throughout the country. We further believe that the expert witnesses called upon to testify did not present accurate information about the role of imports in low dairy prices. For this reason, we believe it is important to set the record straight on many key issues raised during the hearing.

During his testimony Dr. Robert Cropp of the University of Wisconsin made the point that imports are 4% of U.S. production. After reviewing data provided by the U.S. Department of Agriculture (USDA) we find this figure to be incorrect. Currently cheese imports alone account for 2.6% of U.S. production. Casein imports account for 5% of U.S. production. Milk protein concentrate (MPC) imports account for 1.4% of U.S. production. If we add up these more accurate import figures the amount of **dairy imports total 9% of U.S. dairy production.**

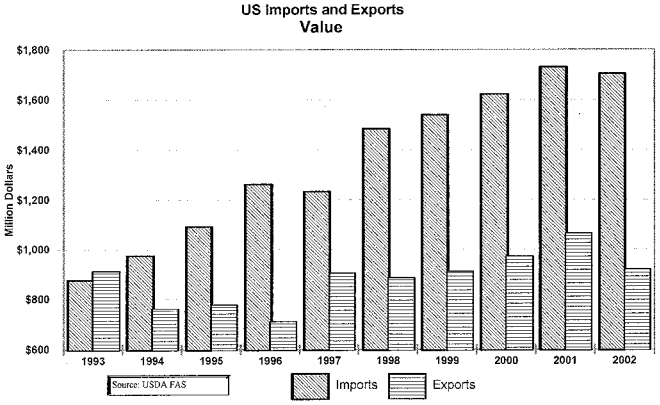
Table 1

IMPORTS (MT)	CONVERSION	MILK EQULIVENT BILLION LBS	PERCENT OF US PRODUCTION
200,000 CHEESE	X 2204= LBS. X 10	= 4.4	2.6%
100,000 CASEIN	X 2204 =LBS. X 39	= 8.5	5.0%
50,000 MPC	X 2204 =LBS. X 22	= 2.4	1.4%
TOTAL MILK DISPLACEMENT		**=15.3**	**9.0%**

NATIONAL MILK PRODUCTION 169 BILLION
CALIFORNIA MILK PRODUCTION 33 BILLION
IIMPORT SOURCE: Department of Commerce, U.S. Census Bureau, Foreign Trade Statistics

Dr. Crop also made the point that on a solids basis, exports exceed imports. The fact that export volume exceeds import volume is misleading when comparing exports to imports. He should have brought to your attention to the value of imports ($1.7 billion) to the value of exports ($0.9 billion) in 2002. The trade imbalance has increased dramatically in the last 5 years, as shown in the graph below (Table 2). This graph demonstrates that our current trade flows are a major cause for low producer prices.

Table 2



It is important for lawmakers to recognize the substantial subsidies that the European Union (EU) imposes on its exports of casein and MPC. At many points during the hearing, witnesses said that U.S. dairy producers could be more competitive in today's marketplace if they produced MPC. However, given the level of EU subsidies of MPC, it is impossible for dairy producers to profit from MPC production. EU and US prices comparisons are shown in Table 3, this table shows the EU prices averaged 24% more than in the US. Further evidence of these subsidize is show in attachments (A & B).

Table 3

INTERNATIONAL MILK PRICE REVIEW for March 2003 Deliveries

All prices expressed in euro/100kg

	Milk Price this Month	Rolling 12 Months
EU Average	29.24	30.86
United States	20.99	24.94
Percent Difference	**28%**	**24%**

Source: On behalf of LTO-Netherland calculated by the Productschap Zuivel in cooperation with the European Dairy Farmers

In her testimony, Connie Tipton of the International Dairy Foods Association (IDFA) made the point that Congress should authorize a permanent forward contracting program for dairy. A forward contracting bill was recently defeated in the California State Legislature because lawmakers agreed that forward contracting would be harmful to producers and consumers. USDA study of the trial program showed that **75% of the producers lost money on forward contracts**. Forward contracting will allow milk processors to have a captive supply of milk. Once processors have a captive supply, demand for milk in the open market will decrease, causing farm prices to fall even further. Forward contracting decreases competition in the market place and **allows processors to pay dairymen below minimum prices;** giving processors even more market power than they have today is not in the best interest of our country.

One very important issue not raised during the hearing is the attack on the definition milk, cheese, yogurt, and ice cream. Consumers have learned to trust the wholesomeness and purity of US produced dairy products. This has been accomplished through a mandatory producer check-off program costing dairymen $250 million annually. The use of anything other than fresh US produced and USDA inspected dairy products puts milks good reputation in jeopardy. The processing industry is trying to capitalize on consumers trust in milk and use cheap imported milk components without the consumer's knowledge. Attachment (C). We are strongly opposed to any changes that will lead to the importation and reconstitution of milk or milk by-products to use in dairy products.

We urge all members of the House Agriculture Committee to oppose forward contracting legislation because it would mean less competition in the marketplace and even lower prices to dairy farmers.

We urge all members of the House Agriculture Committee to sign on as cosponsors of H.R. 1160, the "Milk Import Tariff Equity Act" which would limit imports of milk protein concentrate (MPC), casein and other dairy products by imposing effective tariffs.

We urge all members of the House Agriculture Committee to oppose changes to the definition of milk or dairy products because it would open the door for even more imports leading to even lower prices to dairy farmers and lower food security for the consumer.

We appreciate your attention in this regard and look forward to working with you and other members of the House Agriculture Committee on issues that affect farmers and ranchers.

Sincerely,

Joaquin Contente
President
California Farmers Union

Xavier Avila
President
California Dairy Campaign

U.S. Proposal for Global Agricultural Trade Reform

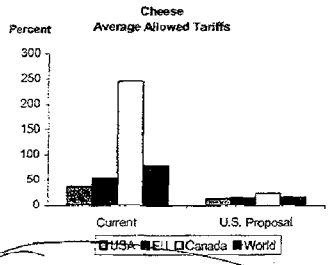
What's at Stake for Cheese?

The July 2002 U.S. agriculture proposal for the World Trade Organization Doha Development Agenda calls for ambitious reforms to open global markets for American agriculture. The U.S. initiative would correct many of the disparities U.S. cheese currently faces at home and abroad.

Market Access

High Tariffs: The average allowed WTO tariff for cheese is 77%.

Reduce and Harmonize Tariffs: The United States is calling for a formula that would reduce high tariffs more than low tariffs with no tariff line greater than 25%, creating more equitable treatment for U.S. cheese.



Export Competition

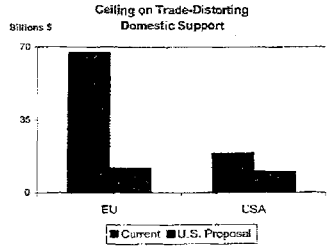
Export Subsidies: While the United States provided $1.7 million in export subsidies to cheese producers in marketing year 2000/01, the European Union (EU) provided $217 million, with an allowance to spend as much as $312 million on cheese exports.

Elimination of Export Subsidies: The U.S. proposal would eliminate export subsidies over a five-year implementation period.

Domestic Support

Trade-Distorting Domestic Support: In marketing year 1998/99, the EU provided $6 billion in "amber box" support to dairy producers. The U.S. provided $4.5 billion in "amber box" support to dairy producers. Norway provided $500 million in "amber box" support and an additional $246 million in "blue box" support.

Reduce and Harmonize Domestic Support: Under the U.S. proposal, the amount of trade-distorting domestic support available to any country would be capped at 5% of the total value of production. For example, the amount available to the EU across all products would drop from more than $67 billion a year to around $12 billion. The "blue box" exemption, which accounted for $22 billion of support in the EU during marketing year 1998/99, would be eliminated. The U.S. maximum allowed trade-distorting support would fall from $19 billion to around $10 billion.



Attachment - A

Trade rules. Import of casein into the United States is free of tariff or quota. Among the major countries exporting to the United States, New Zealand does not subsidize casein production or its export. The European Union does not provide export refunds for casein and therefore does not subsidize casein export. However, the European Union has a support scheme for skim milk manufactured into casein and caseinate. The subsidies vary according to the grades of the product concerned. The aid is fixed such that the income derived from the sale of skim milk processed into casein and caseinate corresponds to that derived from the sale of skim milk processed into nonfat dry milk. The current subsidy rates are about $1.18 per pound of acid casein and $1.25 per pound of caseinate (15.38/16.19 FF/kg, or 2.34/2.46 euro/kg, or 2.61/2.75 usdols/kg).

U.S. Imports

Volume. The United States imported casein and casein derivatives from about forty countries. However, most of these countries supplied only a small fraction of total U.S. import volume. The major sources of U.S. import are highly concentrated. In 1998, ten countries supplied 97 percent of U.S. casein imports (table 9). The top four countries accounted for 79 percent. They were New Zealand (40.4 percent), Ireland (21 percent), France (10.8) and the Netherlands (6.5 percent).

The import volumes by the top 10 countries of origin in the six-year period 1993-1998 are listed in Table 9. Together their share ranged from 93 percent to 97 percent of total imports over the six-year period.

Total imports from all sources showed a steady increase since 1993 (except in 1995 when imports dipped below 1994 levels). Volume ranged from 178 million pounds in 1993 to 245 million pounds by 1998.

DEPARTMENT OF HEALTH & HUMAN SERVICES Public Health Service

Food and Drug Administration
Rockville MD 20857

March 13, 2003

Mr. E. Linwood Tipton
President and Chief Operating Officer
International Dairy Foods Association
1250 H Street NW
Suite 900
Washington, D.C. 20005

Dear Mr. Tipton:

Thank you for your kind words about my participation in the Dairy Forum 2003. I enjoyed the opportunity to address the group and am pleased that your members were impressed with my presentation. Your letter also asks the Food and Drug Administration (FDA) to expedite making a decision on the National Cheese Institute's petition to permit the use of fluid filtered milk in standardized cheeses and related cheese products.

In June 2000, the National Cheese Institute, the Grocery Manufacturers of America, Inc., and the National Food Processors Association submitted a joint petition requesting that FDA provide for the use of fluid filtered milk in standardized cheese. In addition, the American Dairy Products Institute submitted a petition in December 1999 requesting that FDA provide for the use of fluid UF milk in standardized cheese. Taking action on these petitions was not included in CFSAN's Program Priorities for either FY 2000 or FY 2001 given other food safety priorities. Taking action on these petitions, however, was listed in CFSAN's FY 2002 priorities and, accordingly, CFSAN has been developing a proposed rule related to these petitions.

With respect to the request for a temporary marketing permit related to this issue, in August 2002, FDA received a request from a dairy processor for a temporary marketing permit to use UF milk in cottage cheese. However, the initial application did not provide all the necessary information, as required by 21 CFR 130.17. The company provided the missing pieces of information in January 2003 and the request is currently being reviewed by the agency.

Thank you for your interest in this issue. If I can be of further assistance, please let me know.

Sincerely,

Lester M. Crawford, D.V.M., Ph.D.
Deputy Commissioner

Attachment - C