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TO REVIEW USDA DAIRY PROGRAMS

HEARING

BEFORE THE

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UNITED STATES SENATE

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TO REVIEW USDA DAIRY PROGRAMS

THURSDAY, JULY 20, 2006

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington DC

The committee met, pursuant to notice, at 10:05 a.m. in room 328–A at the Russell Building, Washington, DC Hon. Saxby Chambliss, chairman of the committee, presiding.

Present: Senators Chambliss, Coleman, Crapo, and Leahy.

OPENING STATEMENT OF HON. SAXBY CHAMBLISS, A U.S. SENATOR FROM GEORGIA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

THE CHAIRMAN. This hearing will now come to order and good morning. I want to welcome you all to this hearing here this morning, on the Department of Agriculture Dairy Programs and let me tell you a little about what our scenario is going to be. Senator Crapo and I are obviously the only one's here. All members are going to have the opportunity to make a five minute opening statement. We've been notified that other members are going to be here a little bit later on. So, as they come, we'll either let them make their statement as part of their questioning period and not charge that time to them, or we'll allow them to make a statement as they come in. So, if we have to interrupt the panel, know that's the reason for that interruption.

We're fortunate to have the Deputy Chief Economist of the Department of Agriculture Dr. Joseph Glauber, with us today. I'm certain that Dr. Glauber can help us make sense of the various dairy programs our government administers. I'd like to note that USDA Chief Economist, Dr. Keith Collins, was scheduled to be with us here today, but unfortunately, is not feeling well.

Dr. Collins recently celebrated his 30th year of service to the Federal Government, 29 of which have been at USDA. We appreciate Dr. Collins' long record of hard work and dedication to this country, and wish him a speedy recovery. And I would note, that having visited with the Secretary this morning and with Dr. Glauber here a little earlier, that I understand Keith is doing well and is going to be out of the hospital in the next day, or so. And we'll keep him in our prayers and certainly hope for that speedy recovery.

In addition to Dr. Glauber, we have with us today dairy industry leaders from both the private industry and producers who work with dairy cattle each and every day. We appreciate you all taking the time to be with us, and we look forward to hearing from each of you in regard to how USDA dairy programs impact your businesses. I also welcome those listening today via our website.

The United States dairy industry is constantly undergoing change. During the Great Depression of the 1930's, Congress enacted the Federal Milk Marketing Orders in an attempt to ensure a stable supply of milk and provide for the orderly marketing of milk. These orders have experienced great change over the years as we continually attempt to make them more responsive to market forces. From these noble intentions, we have progressed into a network of dairy programs intended to assist the producer when prices are low, ensure a supply of milk for American consumers, assist industry in exporting product, and ensure a uniform price for our producers. This network of programs is complex and often can have different effects on different regions of the country. Over the years, dairy policy has included dairy compacts, base-excess plans, state regulations, voluntary supply controls, the Milk Production Termination Program, and the list goes on and on.

Understanding the complexity of the dairy issue, the Committee on Agriculture has attempted to assemble a group of witnesses today that represent various parts of the country and whose views may differ from program to program. Despite our best attempts, we are mindful that the witness list does not necessarily accommodate all of the regional interests in dairy policy. As such, the Committee is also conducting farm bill field hearings throughout the country. Each of these hearings will provide dairy producers an opportunity to relate to the Committee their unique positions on dairy policy. We are confident that this hearing today, supplemented by the testimony of producers throughout the country, will provide the Committee with a comprehensive view of dairy programs and their effects on all of the Nation's dairy producers. This record will provide us with valuable information as we look to writing a farm bill in 2007.

Many of the issues of concern in the dairy industry are seen through a regional lens. For example, as I have traveled the country and discussed dairy programs such as the MILC income loss program, I know that no matter what my position on this issue may have been -at least half the room would agree with me. This is often the case with many dairy programs, as their intended consequences can often affect producers based on where the producers operation is located or how large or small their operation may be. As we continue to tweak dairy programs to ensure that all stakeholders are able to participate, we must be mindful of the potential impacts on the entire marketplace so that we do not unintentionally stagnate growth, innovation, or negatively affect the competitiveness of the U.S. dairy industry in the international marketplace.

As we meet here today, we are all aware of the cyclical nature of milk production in the United States. The summer months create a tremendous challenge to millions of dairy farmers as they attempt to keep dairy cattle cool and happy. Technological advancements have provided producers with increasing opportunities to meet the demands for milk during these warm months and the steady increase in cow numbers and milk output per cow, particularly in the Western United States, has continually increased national milk production volumes. According to USDA, current 2006 milk production continues to outpace demand resulting in higher stock levels of dairy products and lower prices for milk and dairy products. In addition, high energy costs have affected the dairy industry as they have every other participant in agriculture. It is in this climate of falling milk prices and rising production costs that we conduct this hearing, but again, we must all be mindful of the cyclical nature of milk production and prices.

Today's hearing will provide Members of this Committee with valuable information on how the current dairy programs at the USDA have affected processors, producers, and other dairy industry participants. Later this year, this Committee will conduct another hearing on dairy that will focus on how we should approach this critical segment of the agricultural complex in the 2007 farm bill. It is our hope that this oversight hearing today, coupled with the more forward-looking hearing on dairy later this year and the direct regional producer input we are receiving at the field hearings, will provide the Members of this Committee with the tools and information needed to provide an ample safety net for dairy producers in the next farm bill, while minimizing any potential disruptions in the marketplace.

I, again, want to thank all of our witnesses for being here today. We look forward to your testimony and at this time, I'll turn to Senator Crapo for any statement he wishes to make.

[The prepared statement of Hon. Saxby Chambliss can be found in the appendix on page 34.]

STATEMENT OF HON. MICHAEL D. CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO. Well, thank you very much, Senator Chambliss. And first, I want to thank you for holding this hearing and second, I appreciate and share the perspective that you have given us in your opening comments. I'm not going to take my full 5 minutes, but I do want to thank our witnesses for taking the time to come and attend with us here today, and to participate in this hearing.

I especially want to thank Ken Hall from Idaho, who has traveled out here to share his views on Federal Dairy Policy. And as we take stock of current dairy programs, I think that witnesses like Ken Hall, are going to have a very valuable perspective to provide to this discussion.

You mentioned there were some regional differences and different perspectives on dairy programs, which is to put it mildly, Mr. Chairman, and I think that the perspective you will get from those of us in Idaho is increasingly becoming a very strong concern.

The Idaho dairy industry has been growing at a very rapid pace. In fact, in 2005 Idaho became the fourth largest milk producing state in the Nation with more than 700 dairy operations and over 400,000 dairy cows. The dairy industry in now Idaho's leading agriculture sector, contributing more than $800 million dollars of personal income from activity on dairies in Idaho. So, that's how significant this issue is and it's growing in Idaho.

And what I'm hearing from Idaho dairymen and what you're going to hear later this morning, I think from Ken Hall, is that the Federal dairy support programs are not working. The number of dairies has been decreasing despite Federal dairy programs. And specifically, Idaho dairy producers have concerns with the MILC Income Loss Program—or contract program, or MILC, depresses the price of milk and distorts markets. Further, they want to ensure access to valuable risk management tools such as forward contracting that provide them the means necessary to protect against volatile price differences in the market.

And as this committee begins the process of writing the next farm bill, it's essential to do a thorough review of these programs, and analyze effectively their impact on the industry. I look forward to the discussion this morning, and I again, appreciate the opportunity to share these concerns with you, Mr. Chairman. And I also wanted to say, in conclusion, I appreciate working with you. You're an outstanding Chairman of the Agricultural Committee and you take these issues on head-on and help the rest of us on the committee grapple with them in ways that I think are going to generate much better policy for the country, so thank you very much. Thank you.

The CHAIRMAN. Thanks, Senator Crapo and we're going to start this morning, as I said, with Dr. Joseph Glauber, the Deputy Chief of Economist, United States Department of Agriculture. He is accompanied by Mr. Lloyd Day, the Administrator of the Agriculture Marketing Service, and Ms. Teresa Lasseter, Administer of the Farm Service Agency. So, welcome to all of you and Dr. Glauber, we look forward to your testimony.

STATEMENT OF JOSEPH GLAUBER, PhD., DEPUTY CHIEF ECONOMIST, UNITED STATES DEPARTMENT OF AGRICULTURE, WASHINGTON, DC (substituting for USDA Chief Economist, Keith Collins): ACCOMPANIED BY LLOYD DAY, ADMINISTRATOR AGRICULTURE MARKETING SERVICE AND TERESA LASSETER, ADMINISTRATOR FARM SERVICE AGENCY

Dr. GLAUBER. Well, thanks very much. First, thanks for the kind words about Dr. Collins. He—I did speak with him last night. He should be out of the hospital today and I think he's—hopefully, will be back in the saddle on Monday. I know he regretted missing this hearing. He was talking about it a lot over the last week.

Mr. Chairman and Members of the Committee, Administrator Lasseter, Administrator Day, I thank you for the opportunity to discuss this situation in the U.S. Dairy Industry and the performance to the Federal dairy program as the committees prepare for the 2007 Farm Bill.

U.S. dairy farming has changed dramatically in the last two decades with improvements in transportation and processing, fluid milk markets have expanded from local to regional, and manufactured diary product markets are international in scope. Consumption of dairy products have increased lead by cheese, which has seen per capita consumption rise by over 75 percent since 1980. Today, cheese production accounts for 40 percent of milk use. Per capita consumption of fluid milk consumption continues to decline and now, only accounts for a little over a third of milk production.

The structure of milk production is still changing rapidly as increased productivity, and economies, and size continue to reduce the number of dairy farms and increase average farm size. Since

1980, milk output per cow is up 50 percent and production is increased by nearly one-third, while the number of dairy cows has declined. Today, fewer than 4 percent of U.S. dairy farms have more than 500 cows, but these farms account for nearly 50 percent of milk production.

Milk production continues to expand in the West with California the nation's leading milk producing state and second largest producer of cheese. Western farms tend to be larger and have lower average production costs than farms in other regions. This year, dairy markets are adjusting to 2004's record high milk prices and the near record high prices in 2005. Reflecting these prices, U.S. milk production, the first quarter of 2006 was up 5 percent over the previous quarter—a year over a year quarter.

For all of 2006, we're projecting production to be up more than 2.8 percent, more than twice the trend rate of increase. Consequently, the all-milk price is forecast to average between $12 dollars and 60 cents per hundredweight in 2006, down 17 percent from 2005. This year's lower milk prices, and higher feed, and fuel expenses, as you mentioned earlier, are expected to trim growth in milk production in 2007 to less than 1 percent. With continued strong demand, the 2007 all-milk price is forecast to increase of $13 dollars and 35 cents per hundredweight, up 6 percent from this year. Now, the MILC price support program, Commodity Credit Corporation purchases butter, cheese, and nonfat dry milk at price levels intended to support the price of milk at no less than $9 dollars and 90 cents per hundredweight.

Starting into the late 1990's, CCC began purchasing large amounts of nonfat dry milk, with inventory peaking at 1.4 billion pounds in 2003. Since then, a change in the relative purchase price of nonfat dry milk and butter by the Secretary—excuse me, a change in the relative purchase price of nonfat dry milk and butter, stronger global dairy markets, and donations under domestic and foreign food assistance programs, implementation of livestock feed assistance programs, and CCC sales reduced the nonfat dry milk stocks, held by the CCC, to under 12 million pounds in June. For all of 2006, CCC purchases of nonfat dry milk are projected to reach 105 million pounds, while little to no purchases of butter and cheese are expected.

In addition to the Price Support Program, dairy producers have received more than $2 billion dollars in direct payments under the MILC Income Loss Contract Program—or MILC, for sales during fiscal years 2002 through 2005. As of July 10th, 2006, more than $150 million dollars has been received by dairy producers since payments began in April 2006 following the program extension signed by the President in February 2006. We expect that $1.2 billion dollars in payments will be made during Fiscal Years 2006 and 2007.

The Dairy Export Incentive Program—or DEIP, provides payments to exporters of nonfat dry milk, cheese, and butter to increase their competitiveness in world markets. DEIP exports are limited by quantity and dollar value under the Uruguay Round Agreement. DEIP has not been activated during the past 2 years, however, due to higher world prices, which have enabled dairy exports to be—U.S. dairy exports to be competitive without DEIP assistance. Strong global demand reduced MILC production in Australia and New Zealand, and lower EU dairy export subsidies contribute to the stronger global markets.

In 2005, U.S. dairy exports hit a record $1.7 billion dollars as U.S. MILC producers benefited from tight world dairy product supplies in a weakening U.S. dollar. Trade conditions are similar for 2006. Global demand for dairy products remains firm. The U.S. dollar remains favorable to exports, and U.S. nonfat dry milk prices are expected to remain competitive without export subsidies. Dairy product imports were up in 2005, including MILC protein concentrates, but MPC's remain well below levels reached earlier in the decade.

Last, I want to mention the Federal MILC marketing orders, which established minimum price—minimum MILC prices, handlers must pay based on use. Minimum prices under MILC orders are based on the market prices of dairy products, so orders are not priced in income support programs, nor do they regulate production or the volume of marketings. MILC orders help assure adequate supplies of fresh fluid milk and enable producers to share in the revenues for all milk sold under an order.

Today, 80 percent of the nation's dairy herd sell 65 percent of total MILC marketings under 10 active orders. USDA is in the process of addressing a number of issues through the Federal Order Hearing Process, including redefinition of milk—fluid milk products, and the level of manufacturing, or make allowances used to calculate the value of milk used in cheese, butter, and milk powder products. USDA has also requested proposals on the entire Federal Order Class III and Class IV Price Formula. Other USDA programs that assisted dairy industry are addressed in our written testimony.

As the Committee reviews the dairy situation, several issues that merit consideration. while price and income support programs and direct payments help producers during periods of low prices, programs issues include budget deficit concerns and the tax payer cost of the programs, eligibility criteria used under the MILC Program, the affects of the price support programs and MILC programs on market prices, and the ability of dairy markets to adjust when prices are low. And finally, the consistency to these programs with current and perspective WTO obligations.

Mr. Chairman, we look forward to working with you and your committee members in the months ahead. Thank you.

[The prepared statement of Dr. Glauber can be found in the appendix on page 35.]

The CHAIRMAN. Thank you very much. Some dairy industry participants have complained that the current safety net for dairy producers, which includes both the dairy price support program and the Milk Income Loss Contract program, often disrupts the marketplace by encouraging over production when prices are low. Some also argue that the Dairy Price Support Program inhibits the development of products such as milk protein concentrates and caseinates because it is more profitable to sell nonfat dry milk to the government, than to invest in the manufacturing of these types of products.

Do the Dairy Price Support Program and the MILC Program work in concert to provide a safety net to producers, or do these programs, at times, work at cross-purposes to one another? In your opinion, are these programs working effectively?

Dr. GLAUBER. I guess the answer, at least, is whether or not they're working together or at cross purposes, is probably both yes, at times at least. If we think about how the Price Support Program works, it's a very indirect program. We support prices by purchasing of products. The 2002 Farm Bill has given the Department flexibility to change that relationship, so-called tilt arrangement between the various products. And so, the Department has some flexibility to adjust the relative prices between products, but understand, that it's done indirectly. And in that way, the price of milk is supported to the $9.90 per hundredweight.

The problems, I would say, with the program, is that obviously because it's raising prices, there is a consumer aspect to that of raising consumer prices, but the other thing is the potential product imbalance. Again, the 2002 Farm Bill helped with that, but we have seen certainly periods where we have acquired a lot of stocks of one particular product like nonfat dry milk. And because of that, stockpiles can—when world prices are low, stockpiles can end up growing quite large.

It also can distort markets in the sense of what we saw with—at least back in the late 1990's, or early 2000, with the import of milk protein concentrates. I think that has—we've made some changes where—which I think have mitigated that a great deal since then. But those are some of the cause of the program.

The flip side, of course, is the MILC Program. And there, the MILC Program operates as a direct income program, a counter-cyclical program much akin to some of the programs we run for grains. Their producers receive a price difference based on Boston Class I—the Boston Federal Market Order Class I price and six—administer price of $16 dollars and 94 cents per hundred. That is, they're factored by a—in current legislation by 30—you just get 34 percent of that, but then, that's multiplied times your monthly marketings. Now, those are restricted to 2.4 million pounds per dairy operation, per year. Because of that, that roughly translates to about 120 cows. So, there are a lot of producers—larger producers, of course, who, as we—you had said earlier, produced the bulk of the milk supply, who receive only partial benefits in that case. About 50 percent of the milk produce of the U.S. is covered, more or less, by MILC.

And—but, it does have some potential production impact and in that sense, it's a—it may be cross-purposes with a underlying market price support program. If you're creating incentives to produce more milk, well then, that can potentially cause a price decline and at which point, we—if it gets below $9.90, or the—well, I should say at the product level, then the U.S. Government steps in and we purchase product.

We did do a study of this at Congress's request, and I think about a year and a half ago, or so, and the findings in that study suggest that the production impact of the program actually, was quite small. I think the findings were less than .2 percent. However, there is that and I think that that potential, particularly when prices are extremely low. So, in that sense, I think that there is some potential cross-purposes.

The CHAIRMAN. It's my understanding that last year, a group of dairy cooperatives and private companies came together to petition USDA for an emergency hearing to update the cost data used to calculate make allowances. The USDA responded to this request and held hearings on this issue in January of this year. Many industry participants were disappointed when USDA announced that they would forego a decision on this issue in lieu of an additional emergency hearing in September of this year.

Some industry participants have claimed that this delay costs the dairy industry, particularly dairy product manufacturers, approximately $26 million dollars per month, and could jeopardize the viability of several plants. Can you explain to the Committee the reason for this delay, and has USDA taken into consideration the potential impacts on the dairy industry that this delay could cause, and do you feel it is in the best interest of the dairy industry to delay this decision until further data can be obtained, or should an interim decision be made as several Members of Congress have requested?

Dr. GLAUBER. Well, thanks. I'm going to let Lloyd Day answer some of the questions about the hearing process itself. But first, let me just say that obviously, this is a very important issue, because make allowances ultimately determine purchase prices, so it affects product, the product producers. It also affects dairy producers, ultimately in the forms of the blend prices they receive. It also can ultimately affect price support operations, and also MILC contract payments, potentially. So, it is a very important issue. Let me talk—let Administrator Day take care of the hearing aspects of it.

Mr. DAY. Thank you, Dr. Glauber. Mr. Chairman, thank you for the opportunity to give the Agency's perspective on this, indeed, very important issue. It's an important issue, as Dr. Glauber mentioned, because it affects the price that, not only dairy producers or processors pay dairy farmers, but the operations of naturally those that use dairy for manufacturing processes such as cheese, butter, et cetera.

When we convened this hearing on an emergency basis, the hearing process in the Federal MILC marketing order as allowed for the opportunity for all sides to come in and to present evidence, that eventually is how we base a decision on whether there should be an increase in the make allowance, or in other parts of the price III and IV pricing formulas.

Looking at the data that we received, it boiled down to really two sets of data. One set was from the California Department of Food and Agriculture, which isn't reflective of the rest of the nation, but just the State of California. And the other set, was from the Rural Business Cooperative Service. The problem with the two sets of data, is that they're different sets. One is from California. It looks at large, small proprietary firms. The other, looks at only a survey of cooperatives and doesn't get a broad national scope of all sizes, and proprietary versus cooperative dairies.

We also, during the hearing process, we—even proponents of changing the—using this data, found problems with the data. And thus, we had—prior to even having an emergency hearing, we had contracted with Cornell University to look at the whole national scope, all sizes of the plants, proprietary cooperative, large, small, different types of dairy manufacturing, so that we have a broader national data set to make this important designation.

Now, as we speak, Cornell University is actually meeting with the dairy programs at USDA. I don't know how long it's going to be until they finalize that data. Hopefully, it's going to be very soon. Once we get that data, we're going to make that data public, so all participants, again, have the opportunity to view it. And then, we can move to—toward that interim decision, in order to help those that are coping, as you mentioned, with the rising prices for many, many factors, as well as falling dairy prices.

The CHAIRMAN. Last, Dr. Glauber, the reported aggregate measure of support for dairy totals $4.5 billion. If the WTO negotiations are successful, the United States will be restricted to $7.6 billion in the amber box. It's my understanding, that expenditures for the MILC Program are not included in the $4.5 billion amber box amount, since the program was created after our latest amber box notification in 2001. As a matter of clarification, does the $4.5 billion total for dairy include MILC Program payments? If not, do you anticipate that report aggregate measure support for dairy will increase, once MILC payments are included?

Dr. GLAUBER. In fact, it does not. The aggregate measure of support, the $4.5 billion dollars, that you've sited, does not include MILC. The measure itself is calculated by convention that all countries who have price support programs and for us, it's essentially the Dairy Program and the Sugar Program that fall under this particular methodology. But the amount is calculated on the basis of the difference between the administered price—the $9.90 and a world price, which is an average world price of 1986 to 1988 for fluid milk. That price difference, times the fluid milk production in the U.S. So, that gives you the $4.5 billion. That is trended up, because milk production has been moving up by one to 2 percent per year.

Now, what is added to that is any other dairy program or income transfer, like MILC. So, for example, this year, if—for 1906, we're projecting at roughly $.5 billion dollars in MILC payments, that would be added to the roughly $4.5 billion dollars, giving you $5 billion dollars. So, you—you're absolutely right, when we're looking at a proposal of reducing our AMS by six—60 percent to the $7.6 billion dollars. It would imply, at least, if nothing were done with the Dairy Program under the current 2002 legislation, that the 1906 number, at least, would be roughly 60 to 65 percent of that total.

The CHAIRMAN. OK. Senator Crapo?

Senator CRAPO. Thank you very much, Mr. Chairman. And Dr. Glauber, I want to talk, first, with you about forward contracting. As you probably know, I'm a very strong proponent of forward contracting as a risk management tool that frankly, is frequently used by farmers outside the dairy sector. The majority of the farmers that use forward contracting to lock in prices they can receive for cotton, corn, and wheat. And dairy farmers actually, often utilize forward contracts to lock in feed, fuel, and other input costs. But unfortunately, as we tried to make this program permanent last year, we were unsuccessful in doing so.

At that time, the Department told Congress that the USDA supported making this program permanent, and we're going to be looking at it again, as I'm sure you're aware. And I just wanted to check with you, because I want to make sure that the Department continues to take this position. I know that there was recently was a Farm Bill theme paper that endorsed risk management tools, and I wanted to assure, once again, that the USDA does support making the forward contracting programs permanent.

Dr. GLAUBER. Yes, yes, we do. And we believe that forward contracting provides a good mechanism for producers to share risks. I know there's a lot of criticism of that program, I think some unfounded. The—if you remember the pilot, it applied only to Class III and Class IV uses and so, in the sense that—of undercutting the program, or anything like that of the Federal Milk Marketing Order, because the MILC for manufacturing purpose is not required to be pooled in the Federal Order, regardless of whether or not there's a forward marketing contract, we believe this did not have an adverse affect on that.

Senator CRAPO. Well, thank you very much. I just wanted to be sure to get that on the record, as we continue to deliberate regarding these kinds of matters. And I want to go back now, to the—frankly, the first question that was asked by the Chairman, with regard to MILC, and I know that you've answered that, but I wanted to get into it in a little more detail.

In a report issued by the USDA in October of 2004 on the dairy programs, the USDA reported that the MILC conflicts with Dairy Price Support Program, it actually decreases milk prices paid to producers. According to this report, without the MILC Program, the remaining dairy programs raise the all-milk price by 4 percent, compared to about 1 percent with MILC on an average over 5 years. And in the same report, it was found that when the market prices fall toward the price support safety net and thus, is calling for an adjustment in supply, the results are partially muted by the MILC Program, which by providing production linked funds to producers, may encourage production and retard the supply adjustment. The result being, that milk stays lower—prices stay lower longer than they otherwise would, increasing the likelihood of larger CCC purchases, and raising costs for both programs.

It appears to me, that there's an inherent conflict between the MILC Program and the Dairy Price Support Programs, and do these programs continued existence make economic sense?

Dr. GLAUBER. I think the problem that you've raised, is a legitimate one. That is, the having both in unison, and we—you can make analogous issues about programs in grains or anything else, where we have both price support features and direct payment features. The difference here is that, again, the real difficulty is when prices are extremely low, because it does mute the otherwise price response that producers would have of cutting back production.

Now, again, this is—the MILC Program is limited to a degree, because of the $2.4 billion dollar—million pound limit on how much is eligible for production—or eligible for support. Now, let me just add, as an economist, I might add, if you look at these programs separately, I can see a lot of nice things about a MILC Program, in the sense that it provides an income support, which is—it doesn't distort product—underlying product markets. That it provides some safety net, but doesn't distort the underlying product markets. The—but if you add on top of that a price support program, that is, trying to do the both and I think there are potential problems. Now, again, I would argue that it's minimal in the sense—or it's smaller than many might believe, because of the relative price levels, where we have been. But the danger is exactly at the point when, you mentioned, when prices are extremely low, when they're near support already, and that producers aren't getting the signal to adjust.

Senator CRAPO. Well, I understand that through September 2005, the USDA reported over $2 billion dollars in MILC payments.

Dr. GLAUBER. That's correct.

Senator CRAPO. And I haven't been a proponent of this program, as you know, and many Idaho dairy producers aren't in favor of it either, but the program was considered—or continued in the last reconciliation bill. And I'm concerned that the ongoing cost of this program that depletes funding that could be used elsewhere, is not warranted. And while considerable resources are spent on this program, I understand that dairy farmers are continuing to leave the business at the same rate, as before MILC existed. So, the question I have there, first of all, is that your understanding as well? And also, is this current system the most fiscally sound way to try to provide an adequate safety net for dairy farmers?

Dr. GLAUBER. Yeah, the—I would say that the overall structural changes that are going on in the dairy industry are more being directed by productivity gains and things like that, which are far outstripping—you know, traditionally, or at least historically, over the last 20 years, and I'd say even over the last 10 years if you're looking at outstripping demand. And so, that's a structural imbalance.

Senator CRAPO. But one of—I'm not saying that MILC is causing that, but——

Dr. GLAUBER. Right.

Senator CRAPO. —but I'm saying, it's not stopping it at all.

Dr. GLAUBER. Right. No, that's certainly true. I'm not sure the price support program, either, would necessarily do that, would have much affect either, but your point is very well taken about the compatibility about these programs, necessarily, that one has to consider that.

Senator CRAPO. All right. Thank you. I see my time's expired. Thank you, Mr. Chairman.

The CHAIRMAN. I commented on that earlier. Mr. Leahy, we realized you couldn't be here to start with, any opening statements you wish to make, please feel free to do so.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

Senator LEAHY. Thank you, Mr. Chairman. I'll make a brief one, if I might and we had the voting rights extension bill, one of the most important bills we'll take up this year on the floor. And Senator Specter and I are managing that bill on the floor, so I'll be in and out as a result. I did want to thank you for holding this important hearing on the dairy programs that are in the 2002 Farm Bill.

We're going to have Mr. Leon Berthiaume, who is the General Manager and CEO of St. Albans Co-op. I see Leon back there. Leon has provided a tremendous leadership of Vermont's largest cooperative for many years. I think his wisdom on dairy issues is only exceeded by his practical experience in dealing with them in the real world, so I look forward to his testimony.

We actually had an historic accomplishment—the 2002 Bill that unified national dairy policy that's worked for all dairy farmers from Wisconsin to Vermont to the State of Washington. At the same time, we know the dairy matters are often contentious. But this one, this program brought about tremendous unity in dairy farmers. The MILC Program—and I was glad to hear Mr. Glauber speak about that—or Dr. Glauber speak about that, because that's the vital lifeline of 1,000's of small and medium sized dairy operations.

In my State of Vermont, we depend on the—and in Vermont, agriculture dairy is by far, the most important part. MILC has provided more than $47 million dollars in support that's helped 100's of dairy producers, where the severe market fluctuations. Actually, the law allowed them to stay in business and stay on the farm. And in 2004, the Government Accountability Office agreed. They found that quote, payments introduced through the MILC Program have kept small dairy farms in business, close quote. I agree, it takes some pride knowing MILC is the best-targeted program that USDA operates. It's counter-cyclical; payments are made only when the market price is low. When the prices are good, as they were throughout most of 2005, the program doesn't operate. There's even a firm payment limitation to 125 cows.

Now, under your leadership, Mr. Chairman and under the help of many others, we were able to extend MILC for an additional 2 years. We have overwhelming bipartisan support in this committee and on the floor. The 2002 Farm Bill, we extended the Dairy Price Support Program. That's an effective means of providing a minimal safety net. We also made a historic commitment to working lands conservation programs. That's proven valuable to our dairy producers and others.

The regional equity requirement of the 2002 Farm Bill also guaranteed traditionally under served states of per share in USDA conservation programs. So, we made progress and I appreciate the chance to be here. I would ask, if I might, in my questions of the witnesses, we've had a—probably the worst triple whammy I can ever remember in Vermont's history, this year. We had low milk prices, the highest fuel cost we've ever seen, and then on top of that, we had devastating floods in Vermont in the late spring and early summer. Any one of those would create difficulty. Put together, it's been horrendous.

In fact, the whole State of Vermont has been declared an agriculture disaster by USDA. Now, the Senate has responded to this and other disasters around the country, we added a $4 billion dollar agriculture disaster program to the fiscal year 2007 Agriculture Appropriations Bill. I know the Administration threatened to veto a similar package on the Supplemental Appropriations Bill earlier this year. And so, the House had to remove it during conference.

Has—so, I'd ask the witnesses—let you pick whoever you want—has the Administration's position changed? If so, what's your current position?

Dr. GLAUBER. Certainly, either of my colleagues will respond as well, but as far as I know, it has not changed. And in largely, because in looking at the overall picture in U.S. agriculture in for particularly for 2005, that there were—it's certainly true that we saw some low prices in certain—for certain commodities, we also saw record yields for a number of commodities. And in terms of revenue for a number of commodities, those tended to be up of—just for example, corn was second highest production in yield on record. Soybeans, record yield, second highest production on record. Cotton, record production, second highest yield on record.

Senator LEAHY. So, your answer would be that although there's $4 billion dollars, you'd still be in the same position, the veto would be threatened for that?

Dr. GLAUBER. Well, I—I'm not a Policy Official, Senator, and so I will defer to my two colleagues here, but——

Senator LEAHY. Well, would you say that——

Dr. GLAUBER. I can tell you——

Senator LEAHY. Would it be safe to say that you would not support it?

Dr. GLAUBER. I would not support it.

Senator LEAHY. Thank you. I do thank you for—I disagree with you on that, but I do thank you for extending the MILC Program during the budget reconciliation process last year. I know President Bush endorsed an extension of the MILC Program when he was campaigning in Wisconsin during the Presidential Campaign and your department played a supportive role in our efforts on Capitol Hill to extend the program for two additional years. I look forward to working with Secretary Johanns and Deputy Secretary Conner, of course he's well known to members of this committee on the dairy provision.

I was also pleased to note that you say this—the MILC Program is not expected to have any significant impact on total milk production. I think that was important, because there were many who thought that it would increase production and lower the market price. So, I'm glad to see you disagree, as I do.

On a percentage basis, can you tell us how many U.S. dairy farms are fully covered under MILC with a 2.4 million pound limit?

Dr. GLAUBER. You know, I don't have those numbers right with me. I do know in the aggregate, about 50 percent of milk production is covered, but—but my guess is the number of dairy farms covered would be quite—would be much higher than that, because of the structural things. And—but we certainly can get these numbers.

Senator LEAHY. I'm told it's about 80 percent, and I wondered if you could just submit that?

Dr. GLAUBER. Yeah, my colleagues say that, that is correct.

Senator LEAHY. OK. And would you agree that the MILC Program is highly targeted to small and medium sized dairy farms?

Dr. GLAUBER. Absolutely.

Senator LEAHY. OK. Mr. Chairman, as you know, I've spent years on this committee. I've been very supportive of agriculture around the country. I think that probably by National Security is the ability to have agriculture around the country, but also, have it diversified around the country, so no one part of the country can be wiped out when it has. I know that's your view, too, and I look forward to working with you on this bill. If I have other questions, I'll submit them for the record. Just tell the witnesses, be cautious who's watching you from the wall behind, when you're talking. It'll probably be Senator Lugar, of course. Thank you.

The CHAIRMAN. Well, thank you and you're absolutely correct. You have been a strong advocate for agriculture, period, and you and I went through—have been through two Farm Bills together, as well as a difficult reconciliation process, and I will have to say, you have been a champion for agriculture, period. In particular, obviously, you're parochial interest. But you've always been very kind to my peanut and cotton growers, and you support eating Georgia peanuts, which I noticed you're doing now and we appreciate that.

Dr. Glauber, many dairy industry stakeholders are concerned with the time it takes to amend Federal Orders administratively. Many are concerned that USDA has no incentive to make timely decisions, and that often, difficult decisions are delayed or buried in procedure. I was heartend to hear in your testimony that USDA has developed several new rulemaking initiatives that would address this issue. In fact, your testimony states that the time to complete regulatory action could be reduced by over one-third. What's the current status of these rulemaking policy initiatives, and when might they be released to the public?

Dr. GLAUBER. I'm going to let our AMS Administrator, Lloyd Day, answer that question.

Mr. DAY. Well, thank you, Mr. Chairman, for the question. We've actually begun the new and revised processes to decrease time requirements and we're estimating that we're going to be able to decrease time requirements by about 9 months. Currently, using the Federal Order Rule Making Process, this could be anywhere from 18 to 24 months in order to get the input from everyone, and have these public hearings, and briefs, and then you know—and then finally move on to a final rule.

What we've been doing is pre-hearing meetings to discuss with interested parties before the ex parte restrictions apply to be piloted to improve rulemaking time lines. We've developed supplemental rules of practice to define the public input time lines, once formal rulemaking processes begin and we're also procuring services for court reporters in terms of best value, instead of lowest cost, so we can get better speed in terms of getting a transcript of these meetings back to the hearing. So, these changes are underway right now, sir.

The CHAIRMAN. OK. All right. Well, thank you very much. Senator Crapo, do you have anything else?

Senator CRAPO. I think I have one follow up question.

The CHAIRMAN. Sure.

Senator CRAPO. Back to forward contracting. I just wanted to try to get on the record, a little bit more discussion of that. When we debated this last year, there were supporters of making forward contracting program permanent, but there were also critics whose objections were based on some—what I consider to be some misconceptions of the program. Some of them have argued that if the Forward Contracting Program is made permanent, that it's going to cause the Federal Milk Marketing Orders to collapse, and they argue that processors who forward contracted were not required to participate in the Federal Order Pooling Requirements. I—my question is, is that true, and do you think that the pilot program undercut the Federal Milk Marketing Order system, or exempted participating processors from their obligations to pay into the Producer Fund or the Pool?

Dr. GLAUBER. I—let me answer the last question first, no, I don't think they undercut it. Again, MILC use for manufacturing purposes does not require it to be pooled on any Federal Order regardless of whether or not there's a Forward Contracting Program. Manufacturing processes—processors elect whether or not they wish to have the milk they use pooled based on a comparison of the revenues that will be received from participating versus the costs incurred to participate.

Under the Pilot Program, if manufacture met the Forward Contract Pilot Program requirements, they were allowed to have the milk pooled on an order, but were able to pay less than the Federal Order minimum blend price. I, again, I stress here that the Forward Contracts only apply to the amount of milk in the Class III and Class IV uses. So, since proprietary handles—handlers accounted to the Federal Order Pool, for all the milk they use at Class prices, the full—the pool itself, was unaffected. Consequently, we believe that the program did not undercut—repeat, did not undercut Class V pricing within the Federal Order system.

Senator CRAPO. All right. Thank you. And then, I guess this is just sort of a followup; did the Dairy Forward Contracting Program cost the government anything?

Dr. GLAUBER. I hear no's.

Senator CRAPO. All right. I'll take that as a no from the support staff there.

Dr. GLAUBER. Yeah.

Senator CRAPO. Thank you.

The CHAIRMAN. All right. Thank you very much. We appreciate your being here. We look forward to staying in touch as we get ready to write the farm bill next year, and I'm sure we'll have you back again sometime.

Dr. GLAUBER. Thanks very much.

The CHAIRMAN. And tell Keith, again, we're thinking about him and certainly hope he's back to work soon.

Dr. GLAUBER. Will do. Thank you very much.

Senator CRAPO. That's all?

Dr. GLAUBER. Yes.

The CHAIRMAN. Our next panel that we're going to ask to come forward consists of Mr. Charles Beckendorf from the National Milk Producers Federation, Tomball, Texas; Mr. Jim Green, Kemps LLC/HP Hood LLC on behalf of International Dairy Foods Association, St. Paul, Minnesota; Mr. Ken Hall, a Dairy Producer from Terreton, Idaho; and Mr. Leon Berthiaume, St. Albans Cooperative Creamery, Inc., Swanton, Vermont.

Gentlemen, welcome to each of you and I can't tell you how much we appreciate you taking time out of what I know is a busy schedule for each one of you, to come to Washington, and to share some thoughts with us as we conduct some oversight of the 2002 Farm Bill. We look forward to your testimony. Mr. Beckendorf, we'll start with you, and we'll come right down the row for any opening comments you wish to make. So, welcome and thank you for being here.

STATEMENT OF CHARLES BECKENDORF, NATIONAL MILK PRODUCERS FEDERATION, TOMBALL, TEXAS

Mr. BECKENDORF. Thank you, Mr. Chairman and to you, and the Ranking Member Harkin, and the other Committee Members. I appreciate the opportunity to be here and good morning to you. My name is Charles Beckendorf. I currently serve as Chairman of the National Milk Producers Federation in Arlington, Virginia. I'm a fourth generation dairy farmer in Tomball, Texas and currently dealing with the heat and cows, doesn't work very well down there.

On behalf of the Nation's 60,000 dairy producers, I appreciate the opportunity to review the current status of National Farm Policy in how the 2002 Farm Bill has worked to benefit America's dairy producers and their cooperatives. My testimony will focus on economic policy issues, as well as on other topics impacting dairy farmers profitability.

In 2000 National Milk Producers Federation prepared for the Farm Bill by obtaining grassroots input through our Dairy Producer Conclave process. The results of the Conclave meetings were reflected in many of the positions that we took back in 2001.

To begin with on Economic Policy, the National Milk Producers Federation recommended the enactment of the dairy safety net program, which included several features. Number 1, extending the dairy price support purchase program at $9.90 per hundredweight. Numbers 2, maintaining the CCC purchase price for nonfat dry milk at $1 dollar a pound. Extending the Dairy Export Incentive Program; and establishing a supplemental direct farmer payment program. The 2002 Bill authorized the Dairy Price Support Program from June 1st of 1902 through December 31st of 1907, just as we have requested.

If the Diary Price Support Program had not been in effect during 2002 and 2003, farm milk prices would have been 29 percent below the average level for the previous 5 years. Without the Price Support Program, income received by dairy farmers would have been reduced by an additional $2.4 billion dollars. From June 1902 through June 1906, we estimate that the Price Support Program has prevented a $3.5 billion dollar loss to dairy farmer income, at a cost of $1.1 billion dollars.

The Price Support Program has incurred almost no purchases or costs during the fiscal year of 2005 and the first half of fiscal year 2006, proving that the program is truly a standby state—safety net. The Price Support Program is an effective, efficient, and equitable safety net program and continues to benefit all dairy producers.

There were some goals that NMPF outlined in the 1902 Farm Bill that were not implemented and I'd like to address two of those now. The National Milk which supported the creation of a Class III and Class IV Supplemental Payment Program. Enacting this program would have increased dairy producer income by $5.4 billion dollars between 2002 and 2008. We believe that this supplemental program, coupled with the Price Support Program, could provide a broader safety net for dairy producers. Congress didn't enact our recommendations for the supplemental program, but instead, created a new Direct Payment Program, which came to be know as MILC, or the MILC Income Loss Contract. The National MILC, at this time, still remains neutral on the MILC Program.

The second issue is the ability to assist imported dairy products, the same 15 cents per hundredweight, that American dairy farmers pay for promotion. For 22 years, America's dairy producers have spent billions of dollars on research, advertising, and promotion. Since importers of foreign diary products also benefit from selling in our market, they should also be subject to an equivalent assessment. The imported check off was included in the 1902 Farm Bill and however, due to an implementation concerning the legality of this measure, USDA is determined it cannot implement the import check off without further legislation from Congress. We urge the Senate to work with USDA to address the concerns that have been identified with this provision. This is a measure that Congress should take up well before the next Farm Bill.

On the issue of animal health, notable progress has been made to address a number of animal health related issues that were dealt with in the 1902 Farm Bill. Of greatest significance, is the $464 million dollars in funding that USDA has received for completion of the National Animal Health Research and Laboratory Complex in Ames, Iowa. APHIS and ARS will share this facility, and this will provide the U.S. with a state-of-the-art animal health research and diagnostic laboratory facility.

The National Johne's Disease Control Program was authorized under the 1902 Farm Bill, but not adequately funded. While the Farm Bill contains authorization language, we annually have to fight to obtain funds for the Johne's program. Congressional appropriations have provided USDA with basic funding to administer a voluntary control program for, but more needs to be done with the Johne's program.

On the environmental compliance front, dairy producers have a vested interest in acting as good stewards to—of the environment. Because of this, dairy farmers support environmental regulations based on sound science and uniformed implementation. The most effective way to encourage compliance with regulation is to assist farmers in helping meet complex requirements.

USDA has done a good job of managing the Environmental Quality Incentives Program—or the EQIP Program, which Congress authorized as part of the 1902 Farm Bill. Some of the things farmers are most pleased about with respect to EQIP include the local control over the approval of the cost-share contracts, the increased funding in the 1902 Farm Bill and the increase in the allowable cost-share percentage. Dairy farmers realize this program needs to be further streamlined, and more funding from Congress would also help. Throughout this process, however, it should continue to be a very locally, rather than nationally, driven program.

Trade policy plays a significant role in impacting the direction and effectiveness of government dairy programs. It's likely that trade policy will continue to play a critical role in determining American dairy farmers' profitability. Congress should be involved in carefully reviewing future trade agreements, as well as providing our negotiators with the necessary resources to negotiate and monitor trade agreements.

A key point is ensuring that our rights and responsibilities under current trade agreements are pursued. The Dairy Export Incentive Program is a good case in point.

In 2001, we asked that the DEIP be reauthorized at the maximum levels permitted by the WTO, and Congress did that in the 1902 Farm Bill. Since then, USDA has done a good job of making use of the non-fat dry milk portion of DEIP. However, there have been times when National Milk wanted the USDA make more aggressive use of the program, particularly for butter and, most recently, for cheese.

NMPF remains a strong supporter of the Federal Milk Marketing Orders. Just last month, USDA issued a recommended decision in response to a new milk-based drinks that compete with fluid milk, but do not pay the Class I price. USDA's decision will close a technical loophole and restore equity to fluid milk pricing and we applaud their decision.

Additionally, this spring, USDA stopped large bottling plants in two markets from using an exemption originally intended for small farmers to use. This decision complements the MILC Regulatory Equity Act, which Congress passed earlier this year, and ensures that these plants will compete in those markets on an equal basis with the other plants and producers.

In 2003, dairy producers started a program called Cooperatives Working Together to help strengthen and stabilize farm-level prices. We created a new marketing cooperative to voluntarily pool financial resources to pay for programs that reduce dairy supplies. Our supply reduction activities have helped farmers income and their livelihoods.

However, CWT is not a replacement for government safety net programs. It operates as a complement to—not a replacement of, Federal farm program. It's a unique program in agriculture. We're very proud that farmers of all sizes, in all regions, have come together to cooperate and to help each other economically.

In summary, NMPF believes that the Farm Bill signed by the President in 1902 was a reasonable, rational, and fair approach to farm policy. Most of the items we asked the Senate and House Ag Committees to include found their way into it.

Our message to the Senate is that dairy farmers are not looking for a handout. We're not looking for a hand up; what farmers are looking for from government is a handshake. Dairy farmers want a sign of commitment such as a handshake indicating, when times are tough, there will be a modest safety net in place to help catch those who are vulnerable. National Milk Producers Federation takes comfort in knowing that members of this Committee realize that tremendous impact of the Farm Bill has on U.S. agriculture and look forward to working with Congress and this committee when it's time to collaborate on the next Farm Bill. Thank you for your attention.

[The prepared statement of Mr. Beckendorf can be found in the appendix on page 62.]

The CHAIRMAN. Thank you. Mr. Green.

STATEMENT OF JIM GREEN, KEMPS LLC/HP HOOD LLC ON BEHALF OF INTERNATIONAL DAIRY FOODS ASSOCIATION, ST. PAUL, MINNESOTA

Mr. GREEN. Thank you, Mr. Chairman, members of the Committee. My name is Jim Green, President and CEO of Kemps, a Saint-Paul, Minnesota based dairy company that makes a—makes and markets a wide variety of dairy products including fluid milk, ice cream, sour cream, cottage cheese, dips and yogurt. Kemps is a wholly owned subsidiary of H.P. Hood Company, which is one of the larger dairy companies in America.

I have been in the dairy industry all my life, starting with a family owned business, a family owned dairy in South Central Pennsylvania. And today, I have the privilege of serving with Kemps, as well as serving as the Chairman of the International Dairy Foods Association. Thank you for the opportunity today, to offer my perspective about our National Dairy Policy.

Most of our dairy policies were enacted in the 30's and 40's, although Congress has layered on new programs in recent years. All of this has lead to a current set of programs that's failing our industry, and it's failing the consumer, as well.

And let me explain. Under Federal Milk Marketing Orders created in 1937, USDA requires regulated milk processors to pay minimum prices for milk through a complicated classified pricing, and—and pooling scheme. As a result, many companies are forced to make business decisions around bureaucratic rules, as opposed to making decisions around the marketplace.

No agriculture commodity has a classified pricing system other than dairy. We have heard today about the failure of USDA to update much needed make allowances. In every month that goes by, it's costing the dairy processors around $26 million dollars and it's becoming potentially crippling to our industry.

As long as the Federal order system exists, USDA needs a clearly defined decisionmaking process and firm deadlines. On top of the Federal orders, USDA administers two conflicting dairy subsidy programs, the Dairy Price Support Program and the MILC Income Loss Contract Program. Judging their past performance, I would suggest that reconciling these two counter veiling programs and creating a single program that works, will be one of the greatest challenges as you craft the next Farm Bill. And here's some points to consider as you do that. Through the Dairy Support Program, which dates back to 1949, USDA buys nonfat dry milk, butter, and powder at government mandated prices to support the prices that are paid to dairy farmers. While conceived as a safety net, the program now essentially encourages production of certain products, mainly nonfat dry milk, and discourages production of other products. This program makes it more profitable to sell nonfat dry milk to the government, rather than invest in technology to make milk proteins, which is a product that being increasingly demanded by the marketplace.

The Bush Administration is taking the first step in recognizing they need to change the Dairy Price Support Program by sending Congress legislative language to minimize its negative impacts. We support this goal in ensuring at a minimum this program is managed with greater fiscal responsibility. But frankly, the past performance to the program does not validate its continued existence.

The other subsidy program, MILC, pays dairy producers when milk prices fall below a specific target price. It was put in place as a transition from the failed Northeast Interstate Dairy Compact. It was never intended to be a permanent government program. Since its creation in 2000, we've learned that the MILC Program creates costly government outlays and fans regional divisions among dairy producers. The biggest problem being that MILC conflicts with the Dairy Price Support Program. USDA, through MILC, pays some dairy farmers to over produce. And the USDA through the Dairy Price Support Program buys that excess, buys that surplus in the form of powder, butter, and cheese, and essentially paying twice for the same milk. And needlessly, interfering with commercial marketplace.

The next Farm Bill should reconcile these two conflicting programs and create a single program that really does work. The Dairy Forward Contracting Pilot Program that existed between 2000 and 2004 was a success and we believe it should be reinstated on a permanent basis.

Currently, only diary cooperatives can offer producers this type of price stability. This fair risk management tool creates a level playing field, so all producers—all producers can control their own future and not rely on government expenditures and this program costs the government not a single cent.

The next Farm Bill provides an opportunity for Congress to transition away from ineffective dairy policies of the past, and from our perspective this can be best accomplished by three initiatives. Number 1, initiating a transition from the two current conflicting support programs to a single national dairy farmers safety net that minimizes government interference and provides critical assistance, when it is needed. Second, by leveling the playing field by making the Dairy Forward Contracting Pilot Program a permanent government program. And third, streamlining the Federal Milk Marketing Order decisionmaking process.

Mr. Chairman and members of the committee, the diary processing industry has committed to working with you and the dairy producers to achieve policies that allow producers and processors to prosper and to be more competitive. Thank you very much for this honor.

[The prepared statement of Mr. Green can be found in the appendix on page 70.]

The CHAIRMAN. Thank you very much, Mr. Green. And it was not by accident that we timed Senator Coleman's entrance just as you began. Mr. Green, I want you to notice that.

Mr. GREEN. I appreciate that.

The CHAIRMAN. Mr. Hall

STATEMENT OF KEN HALL, DAIRY PRODUCER, TERRETON, IDAHO

Mr. HALL. Thank you, Mr. Chairman and members of the Committee, my name is Ken Hall. I am a dairy producer from Terreton, Idaho. That's in the Eastern part of the state, and I am before you today representing myself and also the Idaho Dairymen's Association. The Idaho Dairy Association was formed as a dairy producer advocacy group in 1944 and has a dairy producer board of directors that is elected by their peers. All dairy producers in Idaho are members of IDA and pay a one-cent per hundredweight assessment to cover the cost of the organization.

I began working in the dairy industry in 1979 and managed absentee owner farms for roughly 15 years. In 1993, my wife and myself started Hall Dairy, LLC and we started our own operation in Terreton with 100 cows. Today we are milking 2,000 head.

The upcoming farm bill debate should be utilized as a time to review, to determine the long-term effectiveness of agricultural programs. Since the 1930's the government has attempted to assist agricultural producers by replacing the signals of the market that would impact price by keeping supply and demand in check with government signals.

If the intent of the government support programs is to provide an adequate return on time and investment, then the outcomes shows that the programs have failed. In 1981 the Class III price, which is the basis for all milk pricing, averaged $12.57. In 2000 it averaged $9.74. For the 48 months representing 2000 to 2003 40 percent of the time the monthly Class III price was below the $9.90 support price, and with November of 2000 dipping all the way down to $8.57. This extreme volatility and pricing that is lower than prices producers received over 30 years ago, it is a direct result of failed government programs that do not allow the market system to work. The same results can be seen in the corn market. The average price per bushel in 1981 was $2.92 and today it's roughly $2.40.

So, how do agriculturalists survive? They expand by planting more acres or milk more cows, and adapt technology that increases yields. Those who can't adjust leave the business. Since 1981, commercial dairies have been reduced from 225,000 to 64,000, a 72 percent reduction. This begs the question, are the government program—dairy support programs working? The short answer is no.

An example of such a program is the MILC. I believe that it interferes with the free market system by sending false market signals. It also interferes with other government price—dairy price support programs, and discriminates against producers and their operations based on size. In the 2004 USDA Economic Effects Of US Dairy Policy and Alternative Approaches To Milk Pricing Report to Congress stated that there is a basic incompatibility between MILC and other pre-existing dairy support programs.

The Agriculture Department found that MILC does in fact artificially depress the price of milk by—it does, in fact, artificially depress the price of milk by encouraging overproduction. The price support program and the Milk Income Loss Contract program provide an example of problems that can be caused by conflicting policy outcomes. In reality, MILC distorts the market and conflicts directly with other pre-existing subsidy programs all at a cost to—of $2 billion since its inception, nearly twice the $1 billion originally budgeted for it.

The milk price-support program, which dates to the Depression-era Agricultural Adjustment Act, should also be reviewed to determine if it is fulfilling its purpose as intended or inhibiting the market system to function. Under that program, the government steps in and buys dairy products when the price falls below a certain level. If the support price is set low, it provides some income security to farmers while allowing the market to slowly clear and production to fall to the point where prices can rise again. It is our belief that the program no longer serves its stated purpose and allows the price of milk to stay low for an extended period of time, longer than if the market system was allowed to function without government interference. As I have stated above many times since 2000 the Class III price dropped below the support price.

Idaho is viewed as a large dairy producer state, yet 50 percent of our producers milk 200 cows or less and receive full benefit of the Milk Income Loss Contract program. Due to that fact, we studied the Milk Income Loss Contract program thoroughly before coming to a position of opposition. Utilizing the factual data presented by USDA and agricultural economist we struggle to understand why those who have the best interest of dairy producers in mind, including members of this esteemed committee and farm organizations, would continue to support dairy programs that have failed the industry.

One tool that I would encourage including in the 2007 Farm Bill is the permanent authority for all dairy producers to use forward contracting. Simply put dairy forward contracting provides price stability by allowing dairy producers to manage risk. USDA tracked performance during the 2000–2004 pilot program and found that forward contracts were effective in achieving stable prices.

Utilizing forward contracts, dairy producers can service debt more easily, obtain more favorable financing, expand their operations, and guarantee a margin above the cost of production. Dairy producers deserve to have a tool that provides them with the freedom to price every pound of milk they sell before it is produced.

Forward contracting is extensively utilized by other commodities, even those with government support programs, because it allows the buyer and seller to mutually agree on an advance price and they can more predictably basis—and be a more predictable basis for planning their investments and financing needs.

Congress provided the necessary tools for agriculturalist to control their destiny in February 1922 with the adoption of the Capper-Volstead Act. The Act also—the Act, as you're aware allows producers the freedom to work together. National Milk Producers Federation has taken the lead in the formation of Cooperatives Working Together. The program, which is funded—is producer funded, is an example of the Capper-Volstead functioning as intended. Although approximately 50 percent of the milk produced in Idaho is marketed directly to processors and not through cooperatives 84 percent of the milk produced in the state is participating in the self help program.

It is our estimation that the elimination of government-sponsored agriculture programs would allow the free market system to work with producers being protected through the ability to work together under the protection of the Capper-Volstead Act.

Mr. Chairman, I greatly appreciate this opportunity to testify today. Thank you.

[The prepared statement of Mr. Hall can be found in the appendix on page 85.]

The CHAIRMAN. Thank you very much, Mr. Hall. Mr. Berthiaume.

STATEMENT OF LEON BERTHIAUME, ST. ALBANS COOPERATIVE CREAMERY, INC., SWANTON, VERMONT

Mr. Berthiaume. Good morning, Chairman Chambliss and members of the Senate Act Committee. Again, my name is Leon Berthiaume and I'm the General Manager of the St. Albans Cooperative Creamery. I joined the Cooperative in 1984 and had the privilege of becoming the General Manager in 1991.

We are a member of Governed Dairy Cooperative, representing 500 dairy farmer operations and their farm families. Primarily, these farms are located in the state of Vermont, but we do have some in New York, as well as in New Hampshire. We market approximately 1.3 billion pounds of milk on an annualized basis.

Today, as we talk about dairy programs, I feel very strongly that they are vital components to our agriculture industry and I commend the Senate Act Committee in reviewing and assessing the effectiveness of these dairy programs.

When I took this opportunity today, I'm here really as a voice for our dairy farmers and obviously, we've talked a little bit in this opening remarks today about the economic situation that our dairy farmers are facing. Again, we are experiencing again, depressed milk prices, some that bring us back to 2002, 2003, but it can also bring us back to 1979. But at the same time, we are experiencing, as Senator Leahy indicated in his opening remarks, about escalating operating costs, as well as adverse weather conditions. And I can't imagine what crisis we would be in without our dairy programs.

I am in full support that, as USDA, we should have an OR arcing policy to support regional production of milk. Agriculture is an essential part of our rural communities and our economy. The Vermont dairy industry, alone, generates approximately $1 billion dollars in direct economic activity for our state. When we look at the 2002 Farm Bill, there are several dairy programs directly impact dairy producers, their income, and their operations. I'll just touch up on three this morning.

One, has been the economic safety net for dairy farmers. The other, Federal Orders and the third, is conservation programs. I definitely am a proponent for economic safety net policy, which is needed to operate when producer prices could force too many producers out of business and damage our Nation's milk producing infrastructure.

I favor the continued operation of the Dairy Price Support Program and we need to know that there is a floor for manufactured products. It is time to evaluate though, the current targeted $9.90

for the U.S. average manufacturing milk price. We also need to ensure that the mechanism is in place, that prices do not fall below the established targeted level.

The other safety net has been the MILC Income Loss Contract Program and its extension. This has provided much needed economic assistance to our farms in Vermont, when prices have become so depressed. In 2002 and 2003, Vermont dairy farmers received over $45 million dollars in MILC payments. The MILC extension also has been essential in 2006, and our work to date, paying over $2 million dollars to our dairy farmers.

I believe we need to understand the MILC is not a cost, but it is actually investment in dairy farms, in Ag businesses, and processors, and our rural communities. There are significant returns on these investments. As we look to continue to look at safety net programs and the consideration of MILC, we must evaluate the $2.4 million production cap. We need to understand today's farm structure. There has been the need for many farm operations to consolidate or to grow existing family farms to support future generations. We have many multifamily farm operations and that must be considered in the evaluation of the caps.

The orders allow dairy farmers to share equitably in returns of the marketplace. Given St. Albans Cooperative's location of its operation, and its member farms, and its overall size in a relationship to the marketplace, our dairy farmers continue to receive benefit from the Federal Order System.

I would agree with the other remarks made today, that the Federal Order System needs to be streamlined, so that it can respond more quickly to changes when needed.

Relative to conservation programs, conservation programs on that you address those questions promptly, if you do receive any.working agricultural lands brings benefit to both producers and the public. The 2002 Farm Bill added significant authorization for expanded funding to environmental quality incentive program. Vermont has also been committed to improving its water quality and conservation measures. The regional equity requirement was essential to a small state like Vermont to assist our dairy farmers in implementing the necessary and required conservation initiatives. I support to continue funding and the need for the regional equity provision in the future.

In closing, there are many complex issues surrounding the structure of agriculture. We must have a vision for agriculture in this country. We must support this industry with sufficient resources. I thank you, Chairman, and the members of the committee to have the opportunity to participate in today's panel. Your leadership, vision, and understanding are critical to the implementation and oversight of the USDA's dairy programs. I look forward to questions that you may have, or the opportunity to provide additional information to the committee. Thank you.

[The prepared statement of Mr. Berthiaume can be found in the appendix on page 89.]

The CHAIRMAN. Thank you very much. Mr. Green, Mr. Hall, you both gave us your thoughts relative to the issue of Forward Contracting. Mr. Beckendorf, Mr. Berthiaume, what are your positions relative to Forward Contracting being extended to producers?

Mr. BECKENDORF. In national milk, probably most of our members co—member's cooperatives offer a Forward Contracting Program through the cooperative. The Pilot Program was a limited program. We felt like it underminded the minimum pricing and farmers that were involved got less money.

The CHAIRMAN. OK. So, I take it your organization would not support?

Mr. BECKENDORF. No.

The CHAIRMAN. OK. Mr. Berthiaume?

Mr. Berthiaume. Again, as a dairy cooperative, we have provided the opportunity to our members, as well, Forward Contracting opportunities. As it, again, relates, our concern would be again, not to—again, undermine the—again, Federal Order of Classified Pricing System would be our major concern.

The CHAIRMAN. OK. Let me ask this to all four of you, do you support mandatory butter powder tilts as proposed by the Administration in the President's budget for both 2006 and 2007, and are mandatory tilts an effective way to limit government expenditures and purchases of manufactured dairy products, or would these tilts disrupt the market?

Mr. Beckendorf, we'll start with you.

Mr. BECKENDORF. There are already provisions in place to facilitate these tilts when the time comes. We felt like the last two tilts that were done, lead us into 18 months, or 20—24 months of the lowest prices we've had in 25 years. We didn't support the Administration's proposal.

The CHAIRMAN. OK. Mr. Green?

Mr. GREEN. I think the—our position would be that the mandatory tilts—I think the system, the way it is in terms of tilts right now, is operative, that the real issue here is the conflict between the two programs, and the conflict between the Dairy Price Support Program and the MILC Program. And that is the—that inherent conflict that leads to volatility on our industry and volatility on our industry is extremely detrimental, relative to the demand for dairy products.

So, we see the big issue here being the conflict between the inherent conflict—the operating conflict between the two programs.

The CHAIRMAN. Mr. Hall?

Mr. HALL. I think the—my position on it is, that it interferes with the free market. We're—as Idaho dairy association, we're in favor of a free market system, and anything that would possibly—that interferes with that goes against our belief, and that less government interference would be the way we should go. And as dairy producers, that's the way we feel on that.

The CHAIRMAN. OK. Mr. Berthiaume?

Mr. Berthiaume. Again, USDA does have, again, parameters in terms of using its authority as it relates to the tilt. And again, I would suggest that the Department should utilize its tilt authority with the utmost restraint. Certainly, when farm milk prices are on the upswing.

The CHAIRMAN. OK. Senator Crapo?

Senator CRAPO. Thank you. Well, I want to talk to you about both Forward Contracting and the MILC Program. In your testimony, you expressed support for the availability of Forward Contracting as a tool for all producers. Could you just explain to us generally, how Dairy Forward Contracting works, particularly for those who don't have access to it now, those who're not in cooperative, and why it's important for the availability of the Forward Contracting for all producers?

Mr. HALL. Thank you for the question, Senator. As a large dairy producer, having availability of a—to be able to do a Forward Contract allows me to be able to go to my bank and say I've got this price locked in, here are my costs, assuming everything stays fairly much equal, this is the kind of return I'll be able to get on the investment. And so, it helps us to secure financing to go forward, and to be able to expand, and do the things that we're involved in.

Senator CRAPO. And is there any rationale, that you can think of, to say that cooperatives can utilize this tool, but those who are not a member of the cooperative cannot utilize it?

Mr. HALL. I can't think of any.

Senator CRAPO. Let me go on with the—to the MILC Program. In your testimony, you know, one of the debates we have up here, is between small operations and large operations, because the MILC Program is—has—the cap is what, 250?

Mr. HALL. 2.4 million pounds.

Senator CRAPO. Yeah, 2.4 million pounds. One of the debates here is that this is just a debate between large producers and small producers, but as you indicated in your testimony, 49 percent of the Idaho dairy producers milk 200 cows or less.

Mr. HALL. Right.

Senator CRAPO. And they receive the full benefit of the MILC Program.

Mr. HALL. They did.

Senator CRAPO. Yet, they don't get—the Association does not support the MILC Program. Can you explain that?

Mr. HALL. Our position is that it holds prices down longer. It enables inefficiency to remain in business and by that, many producers who maybe are propped up by a support program, and that might be a little bit harsh, but that's the reality of agriculture, and free enterprise.

Senator CRAPO. All right. Thank you. I don't have any other questions, Mr. Chairman, so I——

Senator Coleman

[presiding]. I'll think I'll take the gavel, Senator Leahy?

Senator LEAHY. Thank you, Mr. Chairman. I feel, as I mentioned with the Voting Rights Act on the floor, I've been in and out, but I do want to recognize Mr. Berthiaume. Leon, I'm glad you were able to join us. I know the board is meeting today, without you, so if you give Ralph McNall my thanks for letting you come down. I'm sure you were as disappointed as I was to hear that the Administration will not support the disaster relief that we were able to add to the appropriations bill. I know I'm disappointed, I'm sure you were.

As your testimony pointed out, dairy prices continue to decline. Fuel costs continue to increase. Then the flood, as I said in St. Albans last week, this is the worst triple whammy I've seen certainly in all my years here on the Agriculture Committee. I was there in Paul and Bonnie Bergold's Farm and I saw what happens when you get flooding, low milk price, and doubling or more fuel prices. That hurts.

What would be the situation right now in Vermont if we didn't have the MILC Program?

Mr. Berthiaume. Again, thank you, Senator. I guess first, I would like to say, first of all in Vermont, I think we're already at a critical juncture relative to our dairy industry. We need to maintain the number of cows that we currently have in order to, again, substantiate the infrastructure that we currently have. So, without the MILC and even with the MILC, right now, we are experiencing significant financial stress at the farm levels.

Farms are not cash-flowing. We have farms that are in the process of having to make some serious decisions in terms of. One, do I continue to invest in this industry—No. 1? Two, how much more do I borrow against the equity that I have in my farm? Three, is this really the time that I should be selling out? And then, this is also really affecting the attitudes of our younger generation that are on these farms.

Without the MILC, we would definitely be experiencing a more exodus of farms out of this business, which ultimately would affect the Ag businesses within our state. It certainly would affect the cooperative in terms of the volume of milk that is represented. It would potentially also affect the outlook that our processors would have that invested within our State of Vermont. So, again, the importance of MILC is critical. By, again, just to share the nature of the situation, is that again, based the information, and calls, and visits I've had with dairy farmers, we've also have gone to the State to ask for that additional support because of the crisis that we are experiencing, because of the depressed milk prices, the adverse weather conditions, and the escalating costs.

Senator LEAHY. And even though the committee was able to extend the MILC Program last year, is reduced somewhat. The extended version of the program pays only 34 percent of the difference between the target price of the market price. What did that percentage reduction do to your members?

Mr. Berthiaume. Well, again, I would say that many of our members right now are not covering their cost reduction, and that has certainly been a major challenge that our farms continuing to experience in certainly the reduction in the percentage that might have been received under the MILC, affects the operating cash-flow of our farms. It affects the outlook that our, again, the younger generation has in terms of what stability is there in continuing in agriculture. And it's also continued to again, have farmers make those serious decisions as to which bills do I pay this month versus last month? But again, depending on what that payment, that can range as much as $500 to $1,000 dollars for the month. You know, in terms of the change in the MILC percentage calculation.

Senator LEAHY. Thank you. And Mr. Green, I noted from you testimony, which I did read before I came down, you'd like to revive the Forward Contracting Pilot Program. Congress decided not to extend it. USDA—one of the reasons for that—one of the many reasons, USDA calculated over the life of the Forward Contract Pricing Pilot Program. Producers that are participating receive $7 million dollars less than they would've received if they had not participated. I understand how the program benefits dairy processors, it allows them to pay less than the Federal ordered minimum price for milk, but how again, does it help dairy farmers? Not the processors, but the farmers, themselves?

Mr. GREEN. Our position, Senator Leahy, is that the Forward Contracting Program needs to be a benefit to all processors, a level playing field. And we feel that the—our obligation as a processor to the Federal Milk Marketing Orders——

Senator LEAHY. Not my question, Mr. Green, and my time has run out. So, if you'll go back to my question, I know how it helps the processors is, how does it help dairy farmers—individual dairy farmers?

Mr. GREEN. It can help individual dairy farmers—all diary farmers by allowing them to reduce to have a—make an investment, and have a return that they know into the future, and that they know that they will not have to deal with the price volatility in the marketplace. And it works the same for the processors. It's not—from the processing perspective, it's not an issue. It's not an issue about paying the lower prices. It's an issue about reducing the volatility in the marketplace, and by reducing the volatility in the marketplace to allow our consumption of dairy products to increase.

Senator LEAHY. My time is up. I would disagree, but we could have—or, and Mr. Chairman, again, I thank you for your courtesy and letting me pop in and out on this. And I also appreciate your support. You covered entirely different part of the country than I do, but you've been very supportive of our folks in the Northeast. That means a lot to me.

Senator Chambliss

[presiding]. It's because I like milk, Senator Leahy. They make good milk up there.

[Laughter.]

The CHAIRMAN. Senator Coleman?

Senator Coleman. Thank you, Mr. Chairman. I think you just like food and——

The CHAIRMAN. Thank you.

Senator Coleman. And I do, by the way, want to thank you for giving the committee the opportunity to review dairy programs. The complex nature of dairy policy, USDA implementation of these programs, it really makes a difference in some of my communities, whether they cross or whether they don't. So, it is really kind of life or death decisions in this. And so, I appreciate the opportunity.

I understand Mr. Chairman, that you dealt in your statement—you have dealt with some questions regarding update make allowances. And I don't know if I want to plow through that again. I—Mr. Kemp, and by the way, welcome. It's Mr. Green, Mr. Kemp, it's very welcome—great to have you here. I'd say Kemp's is great, great, great, great Minnesota business, and we appreciate your product, and we want you to be profitable.

I think, you know, the question about Forwarding Contracting is one I've—I'm someone that'll say up front, a proponent of the MILC Program, and obviously there's some disagreement here about that. And I'm also a proponent to Forward Contracting to have some stability. And long-term stability is a good thing, we do it in other areas, and to me, it kind of makes sense. I would—my word of—

if I would offer some advice, one of the challenges we face in dealing with on this committee, is oftentimes, disagreements between us in the end make everybody losers. And we represent what, about 2 percent of the overall population of this country, the agriculture of farmers, producers. Fewer and fewer of our political districts, principal rural in Minnesota, I think you're going to have two out eight there principally rural, so we're shrinking in size. We're not shrinking in—by the way, in productivity. We're doing great in productivity. Dairy is shrinking, dairy has some issues.

And so, I would just urge if there is a way to a little bit of give and take, I don't know if the world is so upended by the MILC Program. I don't—my sense is, I look at Minnesota producers. That I just don't see, you know, great changes on the market because of the safety net, and I see the consequence that Mr. Berthiaume talks about in the absence of that safety net. At the same time, I understand the basic common sense interest in having some stability and it was something like Forward Contracting. Why would we not want to do it? And we start measuring who wins, who loses? If we do that as mathematicians, as a—just—I think we lose. I think society loses something. So, I just wanted to kind of to offer that.

If I can get just one question to you, Mr. Green, about the update make allowances. Do you have anything to say on what the reason for the delay is, has that been articulated to you by USDA?

Mr. GREEN. It was articulated here, this morning, that it's under consideration and hopefully, we'll get a resolution soon. We have a—we have an industry that's losing $26 million dollars a month, Senator, and it's becoming crippling to us as an entire industry, but to specific cheese makers, it's becoming to the point of—coming down to the point of bankruptcy. So, we really need a process here—a decisionmaking process that it comes along with it from deadlines in terms how USDA comes through with this decisionmaking process.

Senator Coleman. And one of the realities in Washington is that we have these hearings, all things get process. I had one with Homeland Security yesterday looking for a manual dealing with credit cards. So, the Department of Homeland Security it's 2 years in the works, and the morning of the hearing, it comes out. And my question is, is—has there been a lack of data or a lack of information that has hampered this process?

Mr. GREEN. There was several months ago, the—there was actually a 4–day hearing in term—where evidence and facts were gathered. In fact, the facts—very parallel situation, when the MILC allowances were first enacted. So, there has been a lot of time and a lot of effort in terms of gathering of evidence, gathering of facts. It seemed, as an industry it's, again, we need a process that has firm deadlines and come to conclusions, right—rightly or wrongly, we have to come to a conclusion. We have a regulation in place now, that essentially fixes margins for these cheese plants, and if you're going to have a—put a regulation that fixes margins, then you need to adjust those. As inputs adjust, you have to take that into consideration in terms of the formulas. So, it's—it gets very frustrating.

Senator Coleman. One final question I might have, I was interested in a—actually, it was I think Mr. Hall mentioned the—was it the CWT Program? Did you talk about that?

Mr. HALL. Yes.

Senator Coleman. I'd be interested—you gave some Idaho figures. Mr. Beckendorf, from a national perspective, can you give me some insight? You had some pretty strong numbers in terms of the Idaho level. Is that kind of a unique situation, or can you give me a national perspective on this CWT Program?

Mr. BECKENDORF. CWT has—well, national milk producers—our membership is core producers of course and we have about 68 or 69 percent of the milk in the country in our membership. Through the CWT Program, because we set it up the way we did as a cooperative, we're able to have independent producers as well, and nonmembers of national milk participate. And so, we're at 70 percent now for a extension. We started out in 2003 at five cents a hundredweight. We tried 18 cents, is what we said we needed and we wound up at a nickel, but we saved the program and it's the best thing that's ever happened to dairy farmers—to get that many people together.

And so, on July the 1st, we went from a nickel to 10 cents and we've got 70 percent of the producers, or the production in the country involved in that. And a lot of that is, as Mr. Hall said, is independent producers, so it's a very good program.

Senator Coleman. OK. Very, very helpful. I appreciate this—I appreciate hearing that. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Mr. Beckendorf, in your testimony you mentioned that USDA could have more aggressively utilized the Dairy Export Incentive Program over the last several years, and in particular, you mentioned the program could increase the export of butter and cheese if used effectively. Would you please comment on how USDA could more effectively administer this program to assist the dairy industry in developing new markets, and their products in other countries?

Mr. BECKENDORF. Am I limited to 5 minutes?

The CHAIRMAN. Whatever it takes.

Mr. BECKENDORF. OK. USDA has never used the DEIP Program for butter to the full extent. We've used powder and it was, as you know, developed to create international markets for the U.S. domestic dairy products. And so, what we've tried to do is use that program, and as Mr.—as the Dr. from USDA said, it's not been used for the last 2 year. It has purchased a little—or CCC has purchased a little bit of powder, recently, in the last two, 3 months. But we think we need to use that to develop the programs. When we look at what's coming down the line in trade policy and WTO, this may be one of the programs that the Ambassadors are going to use to trade away to end the negotiations.

It's going to be pretty hard to trade away a provision if you're not even using it. You know, what value is there there? But, it is a great value to producers to be able to do that, to develop those markets overseas. CWT has done that through export bonuses to the members and has been very successful. So, it's a good program.

The CHAIRMAN. Gentlemen, here's my dilemma. All of you make very strong cases here, this morning, as to why programs are good, or why programs aren't good, and the direction in which we need to go. We've got regional differences; we've got farm size differences. As we look at all of our programs in dairy, we've got to develop a cookie cutter approach to dairy that is going to have to apply to all these farms. And one reason that we have this hearing today, is obviously to look back and let's see how 2002 worked as we move forward, and that's why we're going to have another hearing this fall, to talk more specifically about what we should do moving forward.

So, I just ask that all of you within your organizations, within the farmers that you deal with on a regular basis, that you all continue to think about how we're going to look forward with the dairy program that may have to operate with less money. We don't know what those numbers are going to be, but we may have to. We may have to operate within different—a different atmosphere from a trade perspective. And I would just—I would hope, obviously, that we can get all of our dairy farmers, producers, and everybody together, and processors together on a common theme, but I know that's difficult. But I would just say, that as I listen to each of you, as I listen to Dr. Glauber a little earlier, and somebody who doesn't come from an entirely neutral standpoint, but dairy is not huge in my part of the world. It gets too hot for cows in my part of the world.

But it—this is going to be, as it always is, the most complex part of the Farm Bill and the most difficult part of the Farm Bill to reach a conclusion on. These guys are all my friends and I want to make all my friends happy when we wind up with a dairy program. So, I would urge you to just think through this. Think out of the box. Give us your ideas. Talk to Senator Coleman, Senator Leahy, Senator Crapo, and others about any thoughts that you have, that we might try to develop from a long term standpoint as we write this Farm Bill, because this is going to be the toughest year ever to write a Farm Bill for any number of reasons, and dairy is going to be obviously, critically important to us, and it's going to be a very difficult part of the Farm Bill to write.

So, I thank you. Thank you for being here today, and giving us this insight, and giving us your testimony.

Senator Coleman. Just two things, Mr. Chairman. I want to thank the Chairman, again. What we see is that with this Chairman, is a very focused, concentrated effort to try to deal with the complexity of agricultural quality and in areas that he doesn't necessarily have a dog in that hunt. I've seen it in regard to sugar, seen it in regard to ethanol, but I do think there some ethanol plants now, being built in Georgia, and obviously, we've seen it with dairy. And I just—I want the Chairman to know how much that's appreciated. It's just a very thoughtful way in which he approaches and the challenge that's he's laid out, I share. I associate myself with his work.

So, let me—if I can just ask Mr. Beckendorf one question. I was reflected on the frustration that Mr. Green talked about getting the USDA update and make allowances. And from a national milk perspective, do you share the belief that it's important for the long-term economic health of dairy farmers to make allowances that reflect current cost?

Mr. BECKENDORF. Yes, and—and it's our proposal that these make allowances hold Class I and II whole, that it not affect those, but yes. And we also have been talking to USDA forever about the timeliness of their decisions, and that there needs to be some revision there to speed those decisions up.

Senator Coleman. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. All right. I noticed we have kept a full audience here today, which is unusual. So, there's a lot of interest outside of the committee on what we're going to be doing, relative today in the next Farm Bill, and I can't help but notice my long time, good, personal friend, Mr. Gary Hanman back there.

Gary, a former CEO of Dairy Farmers of America, has been a dear friend of mine for a long time. Gary, thank you for being here. Thanks to all of you for being here. The record will remain open for 5 days; there may be written questions submitted, to you gentlemen, we'd ask

With that, this hearing will be concluded.

[Whereupon at 11.50 a.m., the hearing was adjourned]

A P P E N D I X

JULY 20, 2006

Chairman Saxby Chambliss (R-GA)

The United States dairy industry is constantly undergoing change. During the Great Depression of the 1
in an attempt to ensure a stable supply of milk and provide for the orderly marketing of milk. These ord
continually attempt to make them more responsive to market forces. From these noble intentions, we ha
intended to assist the producer when prices are low, ensure a supply of milk for American consumers, a
uniform price for producers. This network of programs is complex and often can have different effects
policy has included dairy compacts, base-excess plans, state regulations, voluntary supply controls, the
on and on.

Understanding the complexity of the dairy issue, the Committee on Agriculture has attempted to assem
parts of the country and whose views may differ from program to program. Despite our best attempts, v
accommodate all of the regional interests in dairy policy. As such, the Committee is also conducting fa
these hearings will provide dairy producers an opportunity to relate to the Committee their unique posit
today, supplemented by the testimony of producers throughout the country, will provide the Committee
effects on all of the nation's dairy producers. This record will provide us with valuable information as v

Many of the issues of concern in the dairy industry are seen through a regional lens. For example, as I h
such as the milk income loss contract (MILC) program, I knew that no matter what my position on this
agree with me. This is often the case with many dairy programs, as their intended consequences can oft
operation is located or how large or small their operation may be. As we continue to "tweak" dairy prog
participate, we must be mindful of the potential impacts on the entire marketplace so that we do not uni
affect the competitiveness of the U.S. dairy industry in the international marketplace.

As we meet here today, we are all aware of the cyclical nature of milk production in the United States.
millions of dairy farmers as they attempt to keep dairy cattle cool and happy. Technological advanceme
opportunities to meet the demands for milk during these warm months and the steady increase in cow n
Western United States, has continually increased national milk production volumes. According to USD
demand resulting in higher stock levels of dairy products and lower prices for milk and dairy products.
industry as they have every other participant in agriculture. It is in this climate of falling milk prices an
but again, we must all be mindful of the cyclical nature of milk production and prices.

Today's hearing will provide Members of this Committee with valuable information on how the curren
producers, and other dairy industry participants. Later this year, this Committee will conduct another he
approach this critical segment of the agricultural complex in the 2007 farm bill. It is our hope that this c
looking hearing on dairy later this year and the direct regional producer input we are receiving at the fie
Committee with the tools and information needed to provide an ample safety net for dairy producers in
disruptions in the marketplace.

Mr. Chairman, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the structural changes occurring in the dairy industry, the economic outlook for milk and dairy products and the recent performance of Federal dairy programs as the Committee prepares for the 2007 Farm Bill. We will begin by briefly highlighting the outlook for milk and dairy products and the structural changes occurring in the dairy industry and then focus on the primary dairy programs administered by three U.S. Department of Agriculture (USDA) agencies: the Farm Service Agency (FSA), the Foreign Agricultural Service (FAS), and the Agricultural Marketing Service (AMS).

Changing Structure of the U.S. Dairy Industry

U.S. dairy farming has changed dramatically in the last 20 years. Many of these dairy sector changes are the result of market conditions, technological change, productivity growth, economies of scale, and regional shifts.

In the 1930s, nearly 60 percent of milk marketed went for fluid consumption and milk and dairy products were marketed in close proximity to where the milk was produced. Dairy enterprises were often just one aspect of diversified farming operations. Considerable volumes of milk were separated on the farm into skim and cream, with the cream sold to dairy manufacturing plants and the skim milk fed to hogs or other livestock. The manufacturing dairy product industry was concentrated in the Northeast and Upper Midwest.

Now, only 36 percent of milk marketed is consumed as fluid milk and California is the nation's leading milk producing State and the nation's second largest producer of cheese. Milk used on farms where produced has all but disappeared. Due to improvements in transportation and processing, fluid milk markets have expanded from local to regional in scope, and now national markets exist for manufactured dairy products.

Over time, shifts have occurred in consumer preferences for milk and dairy products. Per capita consumption of all dairy products has increased with major growth occurring in per capita consumption of cheese, while fluid milk consumption on a per capita basis has been declining. Per capita consumption of cheese increased by over 75 percent from 1980-2005. Less than half of all cheese is now sold at retail in the form of ready-to-eat or prepared-at-home cheese. Cheese has become a major ingredient in many other foods sold through grocery stores and restaurants.

The structure of milk production is also changing. Advances in technology and improvements in productivity have caused the number of dairy farms to decline and average farm size to increase. Milk yields per cow have increased steadily thanks to genetic breakthroughs, improved herd management, and scientific methods that promote output growth. Since 1980, milk output per cow has risen by 50 percent and milk production has increased by nearly one-third, while the number of cows has declined.

Fewer cows, coupled with increased economies of size, have led to a decline in the number of U.S. dairy farms by more than 70 percent between 1980 and 2003, while the average herd size has increased 300 percent. In 1980, 60 percent of all U.S. dairy farms had 1-29 dairy cows. By 2002, less than 30 percent of U.S. dairy farms fell into that same range. Although dairy farms with small herds still outnumber farms with very large herds, production is increasingly concentrated on the largest farms. Less than 4 percent of U.S. dairy farms have more than 500 cows but these farms produce nearly 50 percent of the Nation's milk.

A favorable climate for milk production, ample supplies of good quality forage, and innovations in technology have caused milk production to expand in the West. Farms in this region of the country tend to be larger and have lower production costs, on average, than farms in other regions of the country. Likewise, dairy processing plants, with the advantages inherent with economies of size, are following milk production operations in this westward expansion.

Outlook for Dairy

Dairy farmers benefited from record high milk prices in 2004 and near-record high prices in 2005 following a two-year period of low producer milk prices. As a result, milk production continues to increase in response to those strong prices, restored availability of a hormone that boosts milk productivity per cow, and generally good forage conditions. In 2006, milk production is forecast to reach 182.1 billion pounds, up nearly 3 percent over 2005. The all-milk price is forecast to average between $12.50 and $12.80 per cwt. in 2006, compared with $15.14 in 2005.

USDA forecasts milk production to expand slightly to 183.1 billion pounds in 2007, or up less than 1 percent, as producers begin to reduce cow numbers in response to higher feed and fuel costs and lower milk prices in 2006. The 2007 all-milk price is forecast to increase and average between $12.85 and $13.85 per cwt., up about 6 percent over 2006, as the result of lower production growth coupled with continued expansion in demand for milk and dairy products.

In FY 2005, U.S. dairy exports hit a record $1.7 billion, as U.S. milk producers have benefited from tight world supplies of dairy products and a relatively weak U.S. dollar over the past two years. Reduced milk production in New Zealand, Australia and the European Union (EU) limited their supplies available for export and robust international demand caused the world price for nonfat dry milk to rise above the support price enabling the United States to be competitive in the world market without the use of export subsidies. In 2005, U.S. exports of nonfat dry milk increased to 611 million pounds, up 20 percent from 2004 and nearly 150 percent above 2003. U.S. imports of butter and American-type cheese declined in 2005, reflecting some moderation in U.S. prices for those dairy products after reaching record high levels in 2004. In contrast, U.S. imports of milk protein concentrate increased from 97 million pounds in 2004 to 121 million pounds in 2005 but remained well below the peak of 143 million pounds in 2000.

Trade conditions are similar for 2006. Global demand for dairy products remains firm, the U.S. dollar continues to be favorable to exports, and U.S. nonfat dry milk prices are expected to remain competitive without export subsidies.

Evolving Dairy Policy: 1930s to 2002

Federal dairy programs have existed in various forms for 70 years having their origins in the depression era of the 1930s. In the 1930s, economic conditions were depressing dairy farmers' income, milk processing and storage capacity was limited and milk marketings were highly variable. Dairy co-ops in existence at that time were unable to stabilize the market for milk and dairy products. To address these concerns, Congress passed the Agricultural Marketing Agreement Act of 1937 authorizing Federal Marketing Orders and Agreements for milk and other agricultural products. The introduction of Federal milk marketing orders helped to stabilize the market by establishing minimum prices handlers must pay for milk.

Since the authorizing legislation was passed in 1937, the Act has been amended numerous times and Federal milk marketing orders are continually being updated through an administrative producer hearing and referendum process. Major changes have included adjusting the number of orders, adopting a uniform classification of products and tying minimum milk prices to manufactured product wholesale prices when the relevancy of the competitive pay price series as a market indicator came into question.

From the inception of the program until the mid-1960s, the number of milk orders increased, peaking in 1962 at 83. Orders began to be merged in the 1960s in response to the development of more efficient refrigerated transportation systems, interstate highways, bulk milk assembly from farms, and the economic changes associated with growth of metropolitan regions and higher-volume fluid milk processing plants. By 1996, the number of orders was reduced to 32 as this merger activity continued. Federal order consolidation and reform, as required by the Federal Agriculture Improvement and Reform Act of 1996 (the 1996 Farm Bill), was implemented in January 2000 and reduced the number of orders to 11. The Western Order was terminated on April 1, 2004, leaving 10 active orders in the current system.

Milk use classes have been adjusted from time to time to reflect the development of new dairy products and advances in milk manufacturing technology. A uniform classification system was implemented across all Federal milk marketing orders in 1974, recognizing that large regional plants were operating across multiple orders and competing regionally for sales of fluid milk and dairy products. Implementation of a uniform classification system meant that processors making like products had uniform or comparative costs. This eliminated the regulatory inefficiencies and different local market definitions, which had begun to create competitive inequities.

Early in the 1960s, the Minnesota-Wisconsin manufacturing grade (Grade B) milk price (the M-W price) became the mover for class prices under most Federal milk marketing orders. The M-W price was the average price received by producers for Grade B milk in Minnesota and Wisconsin as reported by the National Agricultural Statistics Service. The M-W price became widely used throughout the industry as a basic indicator of changes in the farm value of milk.

Use of this competitive Grade B pay price series kept Federal Class prices closely aligned with market values for milk.

After a decade of use, questions were raised concerning the continued use of the M-W price by Federal orders since the volume of Grade B milk was declining. In 1995, after numerous studies of alternatives, a "basic formula price (BFP)" was adopted as a replacement. The BFP was the previous month's value of Grade B milk in the Minnesota-Wisconsin area updated to the current month by a product formula that adjusted the M-W price for changes in the wholesale prices of butter, cheese and nonfat dry milk. However, by 2000, the volume of milk upon which the BFP was determined represented less than 5 percent of U.S. production. Thus, in 2000, as part of Federal milk marketing order consolidation and reform, USDA adopted product price formulas as the basis for pricing all regulated milk because of continuing concerns regarding the accuracy of the BFP as an indicator of the value of milk. The use of wholesale dairy product prices continues to link Federal order milk prices to market supply-demand conditions for milk and dairy products.

The first Federal milk price support program was authorized by the Agricultural Adjustment Act of 1938. The Agricultural Act of 1949 (1949 Act) provided permanent authority for the milk price support program and for support programs of other agricultural commodities. The 1949 Act authorized the Secretary of Agriculture to support the price of milk at 75 to 90 percent of parity by purchasing processed dairy products (butter, nonfat dry milk, and cheese). Parity was a price based on the relationship between farm milk prices and the price of farm inputs during the 1910-14 base period.

A burgeoning oversupply of dairy products coupled with escalating program costs in the early 1980s led Congress to cut the link between the milk support price and parity and to gradually lower the support price. Congress also authorized the Milk Diversion and the Dairy Herd Termination Programs and assessments on milk marketings in efforts to reduce milk production, price support purchases and program outlays. From 1988 to 1995, Congressionally-mandated triggers related to quantities of products purchased were used to adjust the support price. Dairy price support program expenditures, which peaked in FY 1983 at $2.5 billion, declined to less than $0.5 billion in FY 1990, reflecting the decline in the milk support price and assessments paid by dairy producers.

The 1996 Farm Bill authorized termination of the milk price support program on January 1, 2000, and replacing it with a processor recourse loan program. But, dairy prices began to fall in the late 1990s and Congress responded by authorizing emergency supplemental payments to dairy producers and extending the support program.

Current Federal Programs for Milk

Current dairy policy rests on the historical goal to ensure an adequate milk supply through price and income support and orderly marketing. These Federal dairy policy objectives are pursued through several programs managed by USDA, including:

- Milk Price Support Program (MPSP);
- Counter-cyclical payments under the Milk Income Loss Contract (MILC) program;
- Dairy Export Incentive Program (DEIP);
- Federal milk marketing orders (FMMO); and
- Grading, product standards, market news, research and promotion.

Price and Income Support Programs. USDA's price and income support programs for milk and dairy products include: the MPSP, the MILC program and the DEIP. **The MPSP** was initially authorized by the Agricultural Act of 1949 and has been amended numerous times, most recently by the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill). The 2002 Farm Bill mandates that USDA support the price of milk at $9.90 per cwt. through December 31, 2007.

Under the MPSP, purchase prices are established for butter, cheese and nonfat dry milk at a level that enables processors of average efficiency to pay producers an average price that is not less than $9.90 per cwt. for milk containing 3.67 percent milk-fat. The Secretary of Agriculture may adjust the Commodity Credit Corporation (CCC) purchase prices of nonfat dry milk and butter twice within a calendar year to achieve the lowest level of expenditures by CCC or achieve such other objectives as the Secretary considers appropriate. USDA last made an adjustment in the purchase prices of butter and nonfat dry milk in November 2002. CCC maintains an open, standing offer to purchase butter, cheese, and nonfat dry milk from dairy processors at the announced purchase prices. CCC arranges for delivery of the purchased milk products to contracted commercial storage space and makes surplus inventory available for domestic and foreign food assistance programs and for other purposes.

The CCC inventory of nonfat dry milk reached a peak of 1.4 billion pounds in 2003. Stronger milk prices, a lower purchase price for nonfat dry milk (offset by an increase in the purchase price for butter), donations under domestic and foreign food assistance programs, implementation of livestock feed assistance programs and sales for both restricted and unrestricted uses reduced the inventory of nonfat dry milk held by the CCC to 11.5 million pounds on June 9, 2006. The net realized losses to CCC for the inventory reduction during FY 2003-06 exceeded $2.2 billion. From October 1, 2005 through July 7, 2006, 62.3 million pounds of nonfat dry milk have been offered to the CCC under the MPSP of which 38.5 million pounds have been taken into CCC inventory. In calendar year 2006, CCC purchases of nonfat dry milk are projected to reach 105 million pounds, while little to no purchases of butter and cheese are forecast under the price support program.

The **MILC** program was authorized by Section 1502 of the 2002 Farm Bill and extended through September 30, 2007 by Section 1101 of the Deficit Reduction Act of 2005. The MILC program replaced previous Dairy Market Loss Assistance (DMLA) programs that provided payments to dairy producers from 1997 through 2000 and was implemented soon after authority for the Northeast Interstate Dairy Compact expired.

The MILC program provides counter-cyclical payments to milk producers on a monthly basis when the Boston Federal Milk Marketing Order Class I price for fluid milk falls below $16.94 per cwt. Each farm operation is limited to receiving payments on 2.4 million pounds of eligible milk marketings per fiscal year. For production marketed between December 1, 2001 and September 30, 2005, milk producers on eligible dairy operations received a payment equal to 45 percent of the positive difference between $16.94 per cwt. and the Boston Class I price. The 45 percent payment rate was equivalent to the rate paid under the Northeast Interstate Dairy Compact. For production marketed between October 1, 2005 and August 31, 2007, the payment rate percentage declines to 34 percent and to zero percent on September 1, 2007 of the positive difference between $16.94 and the Boston Class I price.

Dairy producers have received more than $2 billion in counter-cyclical payments under the MILC program for production marketed during fiscal years 2002 through 2005. Because of ongoing work to improve computer software, it took FSA less than 60 days from the time the legislation reauthorizing the extension of the MILC program was signed by the President in February 2006 to implement the new changes and begin processing payments to producers. As of July 10, 2006, more than $150 million has been received by dairy producers since payments began in April 2006.

USDA is also responding to the risk management needs of the dairy and livestock sectors by providing whole farm revenue insurance. The Risk Management Agency's (RMA) "Adjusted Gross Revenue Lite" pilot revenue insurance policy is currently available in 17 States and is being considered for expansion into 15 additional States for 2007.

The **DEIP** was initially authorized by the Food Security Act of 1985 and extended by the 2002 Farm Bill. The purpose of DEIP is to develop international markets for U.S. dairy products and to counter EU export subsidies on dairy products. Under DEIP, exporters of nonfat dry milk, cheese and butter can receive payments to increase the competitiveness of these dairy products in world markets, boosting U.S. dairy product export sales. Increased export sales, in turn, lead to higher prices for U.S. dairy products and higher prices to dairy producers.

Under the Uruguay Round Agreement on Agriculture (URAA) export subsidy disciplines, DEIP exports are limited by quantity annually (July/June) to 68,201 tons of nonfat dry milk, 21,097 tons of butterfat and 3,030 tons of cheese. Annual (October/September) monetary limits also exist on DEIP assisted exports and are $82.5 million for nonfat dry milk, $30.5 million for butterfat and $3.6 million for cheese. USDA is constantly evaluating market conditions to determine whether program implementation is justified. Over the past two years, DEIP has not been activated due to high world prices, which are enabling U.S. dairy exports to be competitive without the need of DEIP assistance. This is in large part due to the scaling back of EU export subsidies as a result of mounting budgetary pressures and the export subsidy disciplines prescribed by the URAA.

After interagency and USDA approval, DEIP can be implemented through a public announcement followed by an "invitation to bid" issued to dairy exporters. Exporter bids for a payment bonus are evaluated and allowable bonuses are estimated to cover the differential between global and domestic prices. Awards are made to exporters starting with the lowest bonus requested.

Marketing Programs. USDA administers several programs to facilitate the marketing of milk and dairy products in the domestic and international marketplace, while ensuring fair trading practices, and promoting a competitive and efficient marketplace to the benefit of producers, processors and consumers of milk and dairy products. These programs include: Dairy Market News, the Dairy Products Standards and Grading Programs, the National Dairy Promotion and Research Program, the National Fluid Milk Processor Promotion Program and the Federal Milk Marketing Order Program. These activities are important to the dairy industry because they support both the domestic and international marketing of U.S. dairy products.

The **Dairy Market News** (DMN) program was established under the Agricultural Marketing Act of 1946 (Act) which authorizes funds "to collect and disseminate marketing information, including adequate outlook information, on a market-area basis, for the purpose of anticipating and meeting consumer requirements, aiding in the maintenance of farm income, and bringing about a balance between production and utilization of agricultural products." The information provided by DMN enables dairy farmers, milk processors and other milk and dairy product businesses to better compete by providing high quality, unbiased, timely and accurate economic information on prices, consumption, production and other data for dairy products traded in specific regional, national and global markets. This information assists in the orderly marketing of milk and dairy products and in making market conditions more competitive. Users, representing the full spectrum of the milk and dairy product industry, have direct access to a wide variety of public data made available through several dissemination methods. DMN contributes to efficient market performance by bringing transparency to the marketplace. The existence of DMN ensures free and full access to current, reliable, and unbiased market information for all market participants.

Dairy product standards are an important factor in facilitating commercial trade of dairy products. Rather than compositional standards of identity, which are frequently provided by the Food and Drug Administration, USDA establishes standards that relate to the quality and physical attributes of dairy products, such as taste, smell, texture, appearance and color.

AMS maintains 17 grade standards and 16 quality specifications for dairy products. Dairy products for which there are grade standards may be graded by USDA inspectors, and if approved, may carry a USDA shield showing the product meets the assigned grade. Both grade standards and quality specifications provide a uniform basis for reporting supply, demand and price statistics for such dairy products in *Dairy Market News*.

In addition, USDA actively participates in several international standards setting organizations. Membership in the International Dairy Federation (IDF) allows USDA to play a critical role in the preparation of product standards proposals that are subsequently considered by the CODEX Alimentarius Commission. CODEX is the global reference point for international consumers, food producers and processors and is recognized by the World Trade Organization as an important reference for international trade disputes over sanitary measures.

USDA's dairy product **grading, certification and verification services** provide important third-party services that facilitate commercial sales of dairy production in both domestic and world markets. These services are voluntary and are funded by users. During

2005, USDA employees graded 1.7 billion pounds of butterfat, butter, cheese and nonfat dry milk, representing about 15 percent of total production of those products. Almost all of the butter produced in the United States is graded and carries the USDA quality shield. USDA employees also performed 727 plant inspections and 241 equipment inspections.

An important and growing part of USDA's dairy product grading activities is the issuance of export certificates for dairy products. These certificates attest that U.S. dairy product exports (1) are fit for human consumption, (2) were produced under sanitary conditions and (3) are free from certain animal diseases. When an export certificate accompanies exported dairy products, it assures the buyer that the product was produced under a system of regular audits and inspections to assure that the products meet U.S. requirements for quality and condition. More than 80 importing countries now require or accept USDA dairy export certificates. Often these certificates are required documents for commercial banks clearing letters of credit assuring payment for products.

In 2005, AMS issued 3,568 export certificates covering more than 460 million pounds of dairy products. The certificate program has grown rapidly since it was initiated in 1997, both in volume and the number of certificates issued. In 1997, there were 865 certificates issued on 15.1 million pounds; during 2000, there were 2,309 certificates issued on 36.6 million pounds; and, in 2004, AMS issued 3,521 certificates on 128.7 million pounds of dairy products. Also, the number of different products for which certificates are issued has expanded.

USDA has oversight of dairy **promotion and research programs**, which include the National Dairy Promotion and Research Program and National Fluid Milk Processor Promotion Program. In 2005, the National Dairy Promotion and Research Program and the National Fluid Milk Processor Promotion Program collected more than $273 million and $107 million in assessments, respectively, to develop and implement programs to expand consumption of milk and dairy products.

The enabling legislation for both the producer and fluid milk processor promotion programs requires USDA to submit an annual report to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry. These reports include benefit-cost analyses which indicate that dairy promotion efforts return to the dairy farmer more than $4.00 for every dollar invested in recent years and fluid milk consumption would have been about 9.7 percent less if fluid milk processors had not funded their generic promotion program.

The National Dairy Promotion and Research Program has focused recently on the away-from-home market to promote the expansion of fluid milk flavors and a greater range of packaging in foodservice and restaurants. Dairy Management Inc. (DMI), the staffing and management organization for the National Dairy Promotion Program, has partnered with several restaurant chains to increase their sales of fluid milk. Thus far, during the initial launch in 20,000 restaurants, combined weekly average milk sales have grown sharply. Other restaurant chains will have national rollouts of single-serve containers this summer. In addition to milk, the National Dairy Promotion Program is partnering with a fast food chain to test and market a 7-ounce strawberry yogurt cup that is now a permanent menu option.

The National Fluid Milk Processor Program has been capitalizing on recent research studies that show that the consumption of the amount of calcium contained in three glasses of milk appears to enhance weight loss efforts when combined with a reduced calorie diet and exercise. These generic advertisements, which encourage the consumption of reduced fat milk, are consistent with USDA food pyramid and dietary guidelines. The National Fluid Milk Processor Program also has been advancing the distribution of milk in vending machines.

Federal milk marketing orders are a major part of milk marketing in the United States. In 2005, 114.7 billion pounds, or about 65 percent of total milk marketings, were regulated under Federal milk marketing orders. This is down from 69 percent in the 1990s and 70 percent in the 1980s. The number of producers delivering milk to handlers regulated under Federal milk marketing orders each month in 2005 averaged 53,036, or about 82 percent of all licensed dairy herds.

The Federal milk marketing order system facilitates the marketing of milk by dairy farmers and their cooperative associations, except in certain States and regions. Federal orders regulate handlers who buy milk from farmers and cooperatives for use in fluid milk products. The Federal order under which a handler is regulated depends on where a handler sells fluid milk products, except when the handler is located in a Federal milk marketing order and sells into a State that regulates milk pricing.

Federal orders set minimum prices paid by regulated handlers for milk according to how it is used. Federal order minimum prices for milk in manufacturing uses reflect the wholesale prices of manufactured dairy products, manufacturing costs and milk-to-product conversion factors. The wholesale prices of manufactured dairy products are determined through a national weekly USDA survey of sales by wholesale manufacturers. Minimum Class I (fluid) milk prices are based on current minimum prices for milk in manufacturing uses plus differentials that reflect the additional costs of marketing milk for fluid uses at different locations. Market-generated Class I prices generally exceed Federal order minimum Class I prices, the differences commonly referred to as over-order premiums. Over-order premiums are regularly generated for milk used in other classes as well.

Dairy farmers who supply enough milk to a market's fluid handlers to meet an order's performance standards share in the revenue of all milk sales under the order. Regardless of how an individual dairy farmer's milk is used, the farmer receives at least the blend or market average minimum price for milk sold in all classes. Thus, Federal milk orders provide a structured means of sharing a portion of the market revenues from all the milk sold under the order and compensating for the additional costs of supplying the Class I needs of a market.

The Federal milk order program amasses a considerable amount of data on producer numbers, milk marketings, prices, fluid milk sales and dairy product production that USDA makes available for all market participants. Much of the data are audited by Federal employees assuring the accuracy of the information. In addition, the Federal order program provides weighing and testing services to dairy farmers who do not receive such services from a cooperative association. This assures that payments to producers accurately reflect the volume and quality of milk sold. The funding for the Federal milk order program is derived from assessments, except for $16 million for oversight of marketing agreements and orders.

Federal milk marketing orders do not regulate the volume of milk dairy farmers can sell nor do they guarantee a market for a producer's milk. Producers must find their own market and must arrange for the delivery of their milk to the handlers.

In May of this year, USDA issued a recommended decision redefining the fluid milk product definition under Federal milk marketing orders. Under the proposed definition, products containing more than 6.5 percent nonfat milk solids or greater than 2.25 percent true protein and less than 9 percent milkfat will be classified as Class I products. The 6.5 percent nonfat milk solids and the 9 percent milkfat standards are unchanged from the current definition. The 2.25 percent true protein standard, proposed by the dairy industry, relates to the amount of true protein contained in 6.5 percent nonfat solids. The 2.25 percent true protein standard would be relevant in classifying dairy beverages, such as those with reduced carbohydrates. Drinkable yogurt containing greater than 20 percent yogurt and specially formulated products for infants and the infirmed are proposed to be classified as Class II products.

A national hearing on the level of manufacturing (make) allowances used to calculate the value of Class III (milk used in cheese products) and Class IV milk (milk used in the production of butter and milk powder) products was held in January of this year. After evaluating the hearing record, USDA found that the evidence presented was insufficient for determining the appropriate and reflective costs of manufacturing milk into Class III and Class IV dairy products. Therefore, USDA announced the reconvening of the national public hearing to amend the make allowances. The hearing will be reconvened following the public release of data by Cornell University that reflects the costs of manufacturing by a sample of plants which include cooperative and proprietary plants and small, medium and large plants. In addition, USDA has requested proposals on the entire Federal order Class III and Class IV price formulas. Additional proposals are due on or before September 30, 2006. USDA will proceed as expeditiously as possible on this issue.

Several hearings have been held for the Upper Midwest, Mideast and Central orders that address pooling and re-pooling issues. Interim rules and recommended decisions have been issued. Recommended decision comments were due on April 24, 2006 for all three orders and final decisions are being prepared.

A hearing on transportation credits was held for the Southeast and Appalachian orders on January 10-12, 2006. Briefs were due on March 21, 2006. USDA is in the process of evaluating the record evidence and expects to issue a decision shortly.

Critical Issues and Challenges

We offer some critical issues and challenges for your consideration as this Committee contemplates future U.S. dairy policy. Trade agreements are very important to U.S. agriculture. In FY 2006, the value of U.S. agricultural exports is projected to reach a record $67.0 billion. The URAA increased market access and placed limits on export subsidies, and new multilateral and bilateral trade agreements will provide additional market opportunities for our farmers and ranchers. With respect to dairy, disciplines on export subsidies will ensure that the EU will not return to the massive subsidies that have often pushed international market prices for dairy products artificially low.

Under the URAA, farm programs in which payments are tied to current prices and/or production – or programs that support domestic prices – are considered to be "trade-distorting" and, therefore, included in a country's aggregate measurement of support (AMS). The United States currently has an AMS limit of $19.1 billion, and reported total trade-distorting support of $14.4 billion in 2001, of which $4.5 billion, or 32 percent, was represented by the MPSP. The United States has offered to reduce its bound AMS in the DOHA Round of trade negotiations by 60 percent, or from $19.1 billion to $7.6 billion. If the U.S. proposal is adopted, then modification of the MPSP may be necessary for the United States to meet its commitment on trade-distorting support.

The effectiveness of continuing government purchasing of surplus dairy products through the MPSP, versus offering alternative risk management programs, should be considered in the next Farm Bill. Continued growth of revenue insurance products, use of long term contracting and other risk management tools could be more effective and less market distorting than the MPSP.

Under the MILC program, strict statutory language precluded USDA from altering, expanding or clarifying the definition of dairy operation in any manner other than what was prescribed by the statute. While USDA's administration of the MILC program is consistent with the statute, an audit by USDA's Office of Inspector General (OIG) found variation in how the definition of dairy operation is applied. This inconsistent definition is an issue raised by OIG that USDA cannot remedy administratively.

USDA's cost-benefit assessment of the extended MILC program found that MILC is not expected to have a significant impact (less than 0.2 percent) on total U.S. milk production. In comparison, milk production increased 3.5 percent in 2005. Performance of the MILC program is being assessed by monitoring the effects of MILC payments on slowing the exit of small to medium sized producers. However, it is estimated that the share of milk production and number of producers in these size classes will continue to decline even with continued MILC payments.

The Congressional Budget Office (CBO) cost estimate for MILC at the time the 2002 Farm Bill was enacted amounted to about $1 billion through September 30, 2005. In contrast, MILC payments exceeded $2 billion through September 30, 2005. Because the payment rate under the MILC program falls to zero on August 31, 2007, the program will be authorized but there will be no MILC payments in the budget baseline. Thus, if Congress decides to extend MILC into the future, it will have to decide how much to spend on the program and what proportion of the increase in spending on the MILC program should come from cuts in other programs. The level of funding for MILC could affect the payment rate under the program and the amount of milk marketings eligible for payment.

In July 2004, USDA submitted to Congress a report titled "Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing." That report concluded that "Federal dairy programs have a limited impact on profitability and viability of dairy farms." Congress may want to consider the impact of various dairy programs on trade, farm size and cost when developing the 2007 Farm Bill.

Many in the dairy industry have expressed concern regarding the length of time involved to amend Federal milk marketing orders. USDA recently undertook an extensive internal review of the process for amending Federal orders and has developed several new rulemaking initiatives and customer service standards. The goal is to improve timeliness and transparency while maintaining the opportunity for public involvement that currently exists. Through this initiative, USDA expects to reduce the time required to complete regulatory actions by over one-third.

Summary

The structure of the dairy industry continues to undergo substantial structural change. The number of dairy farms continues to decline as smaller dairy farms drop out of dairy farming or expand to become more economically viable, while the number of large dairy farms continues to expand as producers take advantage of economies of size. In addition, the climate, availability of good quality forage, and other factors are causing milk production to continue to shift to the West. Federal dairy policy will likely have only minor effects on these structural changes.

Federal dairy policy has continued to evolve since the 1930s when 60 percent of milk marketings were used for fluid consumption, compared with 36 percent fluid use today. This legacy should be reviewed under today's marketplace conditions. Extensive government intervention under current programs may not be necessary for providing orderly marketing in milk markets and adequate supplies of high-quality dairy products at reasonable prices.

The Federal budget deficit, market conditions of milk and dairy products, international trade agreements and the effects of the programs on producers, processors and consumers are factors that Congress may want to consider when debating whether to extend the MPSP and the MILC program in the 2007 Farm Bill or replace them with new tools. While price supports and direct payments help to protect producers during periods of low prices, both programs distort market signals and encourage producers to maintain production throughout periods of low prices. Changes to the Federal milk marketing order price formulas can also impact the cost of the MPSP and the MILC program. Furthermore, the MPSP and the MILC program are considered to be trade-distorting programs and subject to discipline under the WTO. Extending the MILC program would add to projected baseline spending and Congress will have to consider whether and how to offset that increase in spending.

We look forward to working with you and your Committee members in the months ahead. Thank you.

Chart 1. Milk Production, Utilization, CCC Removals and Price by Calendar Year

Item	Units	2002	2003	2004	2005	2006	2007
Number of cows	Thous	9,139	9,083	9,012	9,041	9,120	9,030
Milk per cow	Lb.	18,608	18,761	18,968	19,577	19,965	20,275
Milk production	Bil. lb.	170.1	170.4	170.9	177.0	182.1	183.1
FAT BASIS							
Marketings	Bil. lb.	168.9	169.3	169.8	175.9	181.0	182.1
Beg. commercial stks	Bil. lb.	7.0	9.9	8.3	7.2	8.0	8.2
Imports	Bil. lb.	5.1	5.0	5.3	4.6	4.4	5.1
Commercial supply	Bil. lb.	181.1	184.2	183.4	187.7	193.4	195.4
Commercial use	Bil. lb.	170.9	174.7	176.4	179.7	185.2	187.5
Ending commercial stks	Bil. lb.	9.9	8.3	7.2	8.0	8.2	7.9
Total utilization	Bil. lb.	180.8	183.0	183.5	187.7	193.4	195.4
CCC net removals 1/	Bil. lb.	0.3	1.2	-0.1	0.0	0.0	0.0
SKIM SOLIDS BASIS							
Marketings	Bil. lb.	168.9	169.3	169.8	175.9	181.0	182.1
Beg. commercial stks	Bil. lb.	8.1	8.5	8.5	8.2	9.0	9.0
Imports	Bil. lb.	5.1	5.0	4.8	4.5	4.7	5.7
Commercial supply	Bil. lb.	182.1	182.8	183.1	188.6	194.6	196.8
Commercial use	Bil. lb.	163.9	166.2	173.7	180.6	184.4	185.7
Ending commercial stks	Bil. lb.	8.5	8.5	8.2	9.0	9.0	8.8
Total utilization	Bil. lb.	172.4	174.7	181.9	189.6	193.4	194.5
CCC net removals 1/	Bil. lb.	9.7	8.1	1.3	-1.0	1.2	2.3
CCC NET REMOVALS 1/							
Butter	Mil. lb.	0	29	-7	0	0	0
Cheese	Mil. lb.	16	41	6	-2	0	0
Nonfat dry milk	Mil. lb.	824	664	105	-81	105	195
DEIP EXPORTS							
Butter	Mil. lb.	0	22	1	0	0	0
Cheese	Mil. lb.	3	6	6	0	0	0
Nonfat dry milk	Mil. lb.	162	149	106	0	0	0
PRICES REC'D BY FARMERS							
Class III	Dol/cwt	10.42	11.42	15.39	14.05	11.55	12.45
Class IV	Dol/cwt	10.81	10.00	13.20	12.88	10.65	11.00
All milk sold to plants	Dol/cwt	12.18	12.55	16.13	15.14	12.65	13.35

1/ Includes DEIP exports.

Chart 2. Consumption of Milk and Dairy Products

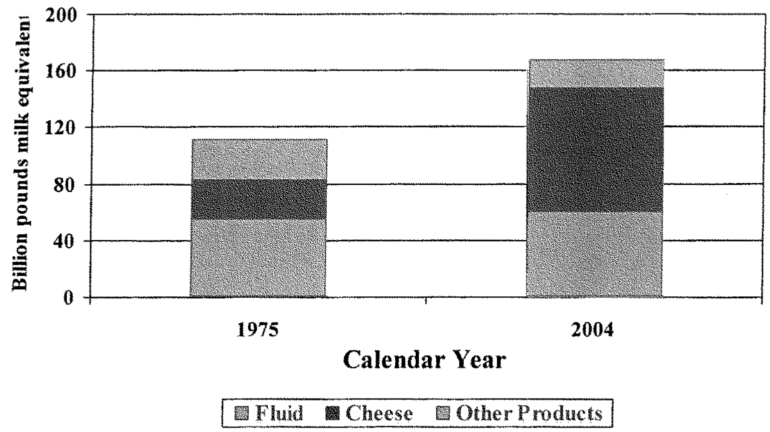


Chart 3. Number of Milk Cows and Milk Production Per Cow

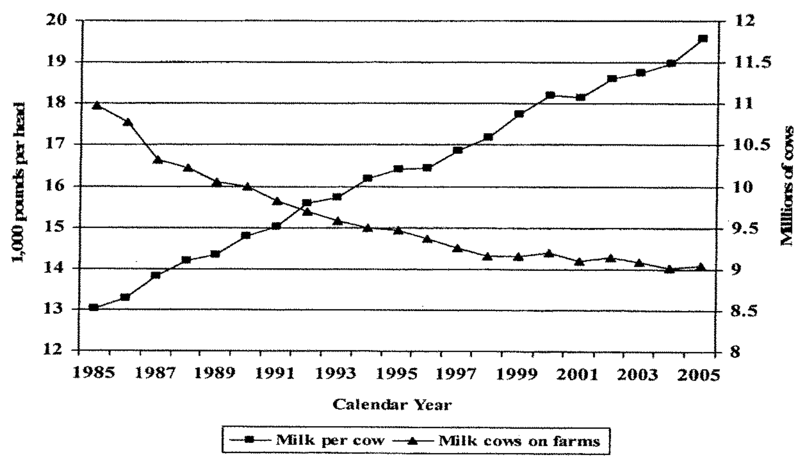


Chart 4. Milk Production: Changes in Regional Production Shares

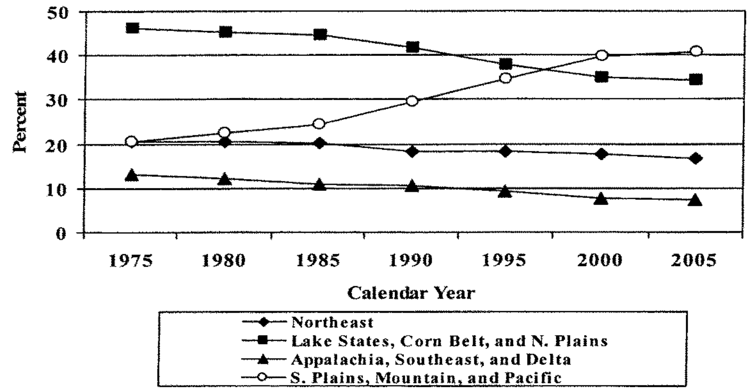


Chart 5. Number of Dairy Farms with less than 500 Cows and 500 or more Cows

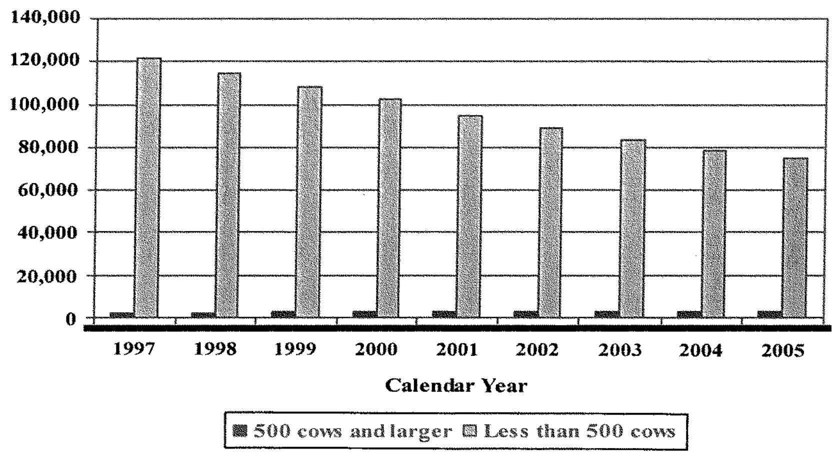


Chart 6. CCC Net Outlays for Dairy Programs

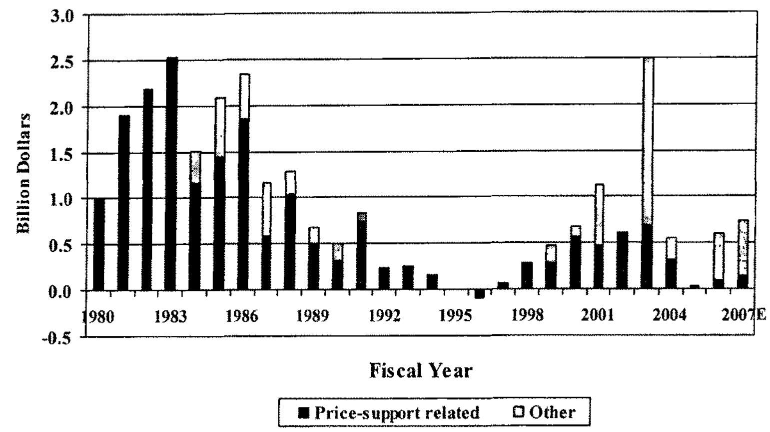


Chart 7. All-Milk Price and Support Price for Milk

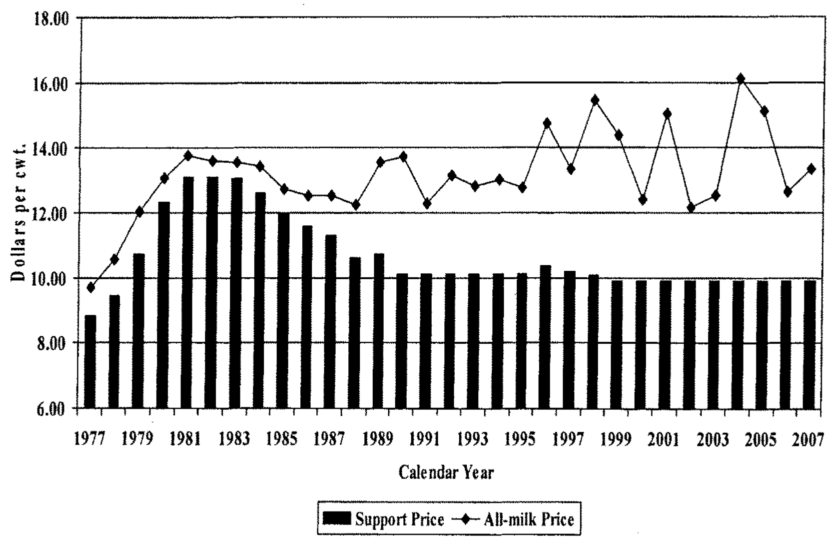


Chart 8. CCC Inventory, CCC Purchase Price and the Wholesale Price of Nonfat Dry Milk

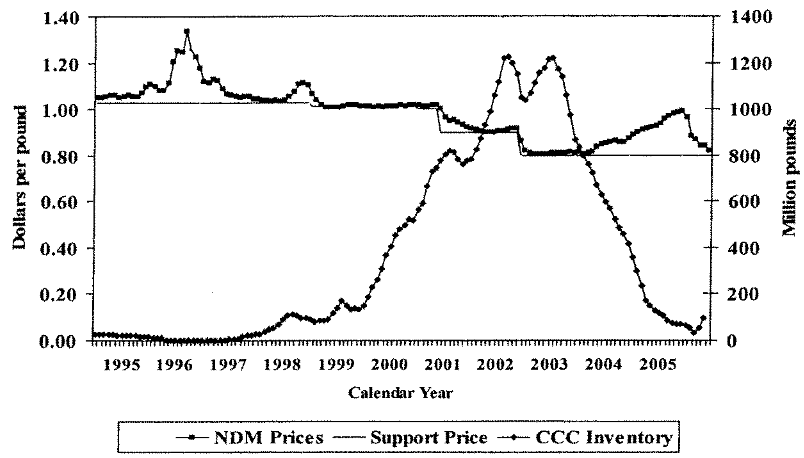


Chart 9. Nonfat Dry Milk Production, Purchases and Exports

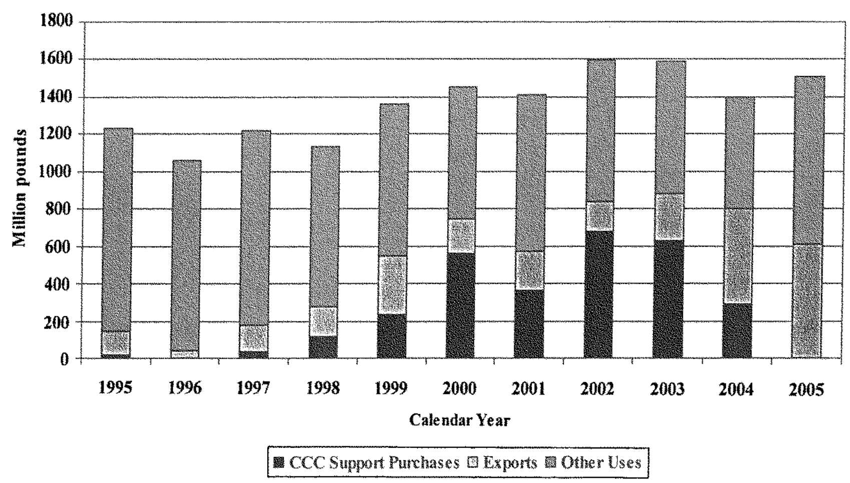


Chart 10. U.S. Imports of Selected Dairy Products (mil. pounds)

Calendar Year	Butter and Butter Equiv. of Butter Substitutes	American Cheese	Cheese Other Than American	Milk Protein Concentrate	Casein
2000	30.2	45.9	370.1	142.9	163.5
2001	82.3	68.6	368.1	78.1	135.8
2002	36.1	84.0	388.2	91.4	126.8
2003	33.2	68.0	408.6	106.4	153.1
2004	55.0	66.6	393.8	96.6	147.2
2005	42.9	40.2	392.4	121.3	153.9

Source: U.S. Census

Chart 11. U.S. Exports of Selected Dairy Products (mil. Pounds)

Calendar Year	Butter and Butter Equiv. of Butter Substitutes	Cheese	Skim Milk Powder [1]
2000	18.1	105.3	185.7
2001	8.4	115.4	211.8
2002	8.5	118.8	164.0
2003	25.5	114.9	249.9
2004	19.8	135.3	510.6
2005	18.9	126.8	610.8

Source: U.S. Census

STATEMENT OF THE
NATIONAL MILK PRODUCERS FEDERATION
CONCERNING

THE 2002 FARM BILL

TESTIMONY BEFORE
THE U.S. SENATE
AGRICULTURE COMMITTEE

JULY 20, 2006

PRESENTED BY
CHARLES BECKENDORF
CHAIRMAN, NMPF

Good morning, Chairman Chambliss, Ranking Member Harkin, and the other members of the Senate Agriculture Committee.

I am Charles Beckendorf, the Chairman of the National Milk Producers Federation in Arlington, Virginia. I am also a fourth-generation dairy farmer in Tomball, Texas.

On behalf of the nation's 60,000 dairy producers, I appreciate the opportunity to review the current status of national farm policy, and how the 2002 Farm Bill has worked to benefit America's dairy producers and their cooperatives. My testimony will focus on economic policy issues, as well as a range of other important topics that impact dairy farmers' profitability. Sometimes the only way to see ahead is to look back, so I think it's appropriate to look back to how – and why – NMPF worked with Congress to develop the policies that they did five years ago.

In 2000 NMPF began preparing for the Farm Bill by holding a series of meetings throughout the country to obtain input from dairy farmers regarding the future direction of government policies affecting them. The net result of these Dairy Producer Conclaves was reflected in many of the positions that we shared with the House, the Senate, and the USDA concerning dairy farmers' desired goals for the 2002 Farm Bill. NMPF conducted a similar Conclave effort earlier this year in preparation for the 2008 Farm Bill, but the outcome from that process will be the focus of later hearings. As such, the comments contained herein focus on the existing dairy policies and the impact they have had on the U.S. dairy industry.

Economic Policy - Dairy Safety Net

Back in 2001, NMPF recommended the enactment of a dairy safety net program with the following features:

1. Extending the dairy price support purchase program at the current support price of $9.90 per hundredweight.
2. Maintaining the CCC purchase price for nonfat dry milk of approximately $1.00 per pound.
3. Extending the Dairy Export Incentive Program (DEIP), whose legislative authority was to expire on December 31, 2002. We will review that in the Trade section.
4. Establishing a supplemental payment program involving Class III and Class IV milk.

NMPF advocated that Congress extend the dairy price support program (DPSP) as part of the 2002 Farm Bill because the DPSP has proven to be an effective means of providing a minimal safety net to prevent major disruption to dairy producer prices and incomes at relatively low cost to the government. In addition, our safety net allows for consumers and processors to have ample supplies of economical, wholesome and nutritious dairy products.

The 2002 Farm Bill authorized the DPSP from June 1, 2002, through December 31, 2007. In the twelve months immediately following the program's reauthorization, July 2002 through June 2003, the U.S. dairy industry experienced a substantial imbalance between supply and demand due primarily to a surge of milk protein imports, as the International Trade Commission noted in its May 2004 report. Prices received by dairy farmers throughout the country dropped to 25-year record low levels for most of that twelve month period. It was a period of severe financial stress and instability in the industry. However, if the DPSP had not been in effect during this period, milk prices received by farmers would have averaged about 29 percent below their average level for the previous five years, turning the period into an all-out disaster for dairy producers across the United States. In addition, many non-dairy industries in rural communities would have suffered equally. Without the DPSP in effect, income received by dairy farmers from the market would have been reduced during this time by an additional $2.4 billion, to a level that would have been 25 percent below the previous five-year average, by our calculations.

In contrast, the gross cost of the dairy product purchases necessary to prevent this significant loss to the industry was only approximately $600 million. Moreover, the actual cost of the purchases under the program to the government during those months was less than this amount, because some of the products acquired were later sold back into the commercial market, and most of the remainder has been used to carry out domestic and overseas donation activities, enabling the government to achieve important nutritional and foreign assistance goals.

In marked contrast to that earlier period, the DPSP has incurred almost no purchases or costs during fiscal year 2005 and the first half of fiscal year 2006, proving that the program is truly a stand-by safety net program. For the entire period of the current program authorization to date, June 2002 through June 2006, we estimate that the DPSP has prevented a $3.5 billion loss in dairy farmer income, at a gross cost of product purchases of approximately $1.1 billion. The DPSP is the most effective, efficient and equitable safety net program, and it continues to benefit all dairy producers.

NMPF 2002 Farm Bill Goals As Yet Unmet

There were some goals that NMPF outlined for the 2002 Farm Bill which were not embraced by Congress, however; or which were included in the Bill, but have not yet been implemented. I would like to touch on two of those in particular.

The first pertains to dairy product Class prices. In our Farm Bill position in 2001, NMPF developed a rationale for enacting a Class III (cheese) and Class IV (butter and nonfat milk powder) supplemental payment component of a dairy safety net. Enacting a supplemental payment program for milk used to produce manufactured dairy products would have increased dairy producer income by $5.4 billion over the 2002-2008 period. Since Class III producers would have been the primary recipients of this income, the program would have significantly helped this segment of the dairy farmer community. We believed at the time that this supplemental payment program, when coupled with a continuation of the dairy price support program, could provide the basis for a safety net for dairy producers throughout the United States.

The Congress did not enact our recommendation for a Class III and IV supplemental, but instead created a new direct payment program in the 2002 Farm Bill which has come to be known as the MILC (Milk Income Loss Contract) program. NMPF remains neutral on the MILC program.

The second issue concerns the ability to assess imported dairy products the same 15 cents per hundredweight that American dairy farmers pay to grow the demand for dairy products in the U.S. Dairy products from foreign suppliers have benefited from a healthy and growing $90 billion U.S. dairy market. Part of the reason for the growth of the U.S. market is that for 22 years, America's dairy producers have spent billions of dollars – more than $260 million this year alone – on research, education, advertising, and promotion. Since importers of foreign dairy products also benefit from selling into our market, they should also be subject to an equivalent assessment to help pay for the promotion program that helps boost the sales of all dairy products. This is already an established practice: beef, cotton and pork importers are currently assessed at the same rate as domestic producers.

Congress recognized the need to update the dairy checkoff program by applying the assessment to imported dairy products as well. As a result, the import checkoff was included in the 2002 Farm Bill. However, due to an interpretation concerning the legality of this measure, USDA has to date determined that it cannot implement the import checkoff without further legislation from Congress. We urge the Senate to work with USDA to address the concerns that have been identified with this provision and to swiftly pass the legislation needed to address them. This is a measure that Congress can and should take up well before the next Farm Bill. NMPF urges members of this Committee to work with their colleagues to act quickly on this issue of great importance to the U.S. dairy industry.

Having provided a high-level examination of the major dairy policies and current ongoing issues, I would like to now expand on a few additional topics of importance to dairy farmers and examine how the 2002 Farm Bill has impacted developments in those areas.

Animal Health

Notable progress has been made to address a number of animal health related issues that were dealt with in the 2002 Farm Bill. Of greatest significance is the $464 million in funding that USDA has received for completion of the National Animal Health Research and Laboratory Complex in Ames, Iowa, which the Animal Plant Health Inspection Service and Agriculture Research Service will share. This will provide the U.S. with state of the art animal health research and diagnostic laboratories to address emerging animal disease concerns that affect public and animal health, as well as our foreign trading status.

The National Johne's Disease Control Program was authorized under the 2002 Farm Bill, but not adequately funded. While the Farm Bill contains authorizing language, we annually have to fight to obtain funds for the Johne's program. Congressional appropriations have provided USDA with basic funding to begin to administer a voluntary control program for this disease in 46 states. In addition to educational and training efforts for veterinarians, USDA has been able to assist some 70 laboratories to correctly detect and report this disease. Some 60,000 cattle now comprise 67 Johne's demonstration cattle herds in 16 states to develop best management practices to control this progressive enteric disease of ruminants.

Continued progress is also being made by USDA to control Bovine Tuberculosis. Additional funding was authorized in the 2002 Farm Bill to enhance border control of this disease with Mexico, improve trace-back from cow slaughter plants, utilize indemnity payments to eradicate this disease from the panhandle of Texas, and assist Michigan to overcome an outbreak of the disease from wildlife. NMPF appreciates the initial work USDA has put in with respect to each of these efforts, and anticipates future funding of these measures to allow USDA to continue to tackle these important issues.

Environmental Compliance Assistance

Dairy producers have a vested interest in acting as good stewards of the environment since they depend on the health of their land and water to remain profitable. Because of this, dairy farmers support environmental regulations based on sound science. However, the most effective way to encourage compliance with these regulations is to assist farmers in helping make sense of, and meet, often complex requirements.

USDA has done a good job of managing the Environmental Quality Incentives Program (EQIP), which Congress authorized as part of the 2002 Farm Bill. As our industry and milk production continues to grow every year, environmental concerns become an ever-larger issue with which to contend. In response to this, dairy farmers from coast to coast are using EQIP to help manage those concerns. Some of the things dairy farmers are most pleased about with respect to EQIP include the local control over the approval of the cost-share contracts, the increased funding in the 2002 Farm Bill and the increase in the allowable cost-share percentage. Dairy farmers realize that this program needs to be further streamlined, and more funding from Congress would also help. Throughout this process, however, it should continue to be a very locally, rather than nationally, driven and focused program.

The Conservation Security Program (CSP) also has some potential, but it has not been embraced as enthusiastically as EQIP. Farmers whose operations are located in Priority Watersheds receive benefits from CSP. While developing a program so that it targets the most impaired watersheds first is entirely understandable, farmers who want to implement conservation practices but are not located in a CSP Priority Watershed feel left out. NMPF hopes to work with Congress and USDA in the future to address this issue so that this program too can be one that dairy farmers point to as an excellent example of how this Administration and Congress recognize the environmental challenges farmers face and are ready to assist in addressing them.

Trade Policy

Trade policy plays a significant role in impacting the direction and effectiveness of government dairy programs. Given that one of the core pillars of the Doha WTO Round is domestic support, and that additional free trade agreements could impact the level of imports into the U.S., it is highly likely that trade policy will continue to play a critical role in determining American dairy farmers' profitability and sustainability. Consequently, NMPF believed in 2001, and we believe today, that Congress should be involved in carefully reviewing future trade agreements, as well as providing our negotiators with the necessary resources to negotiate and monitor agreements.

To date, many members of Congress, including a great many on this Committee, have shown an admirable willingness to actively work with the U.S. Trade Representative's Office (USTR) and USDA throughout the negotiating process, in order to provide feedback about how to best achieve a balanced agreement. NMPF would also like to applaud the dedication, skill and responsiveness shown by our negotiators at USTR and USDA in trade discussions. Their efforts have to date secured important new trading opportunities for the U.S. dairy industry in a variety of trade agreements, while ensuring that our domestic programs are not negatively impacted. I must note, however, that an agreement with a net exporter of dairy products that does not offer any incentives for dairy producers, nor the U.S. dairy industry as a whole, could have significant detrimental costs not only to dairy producers, but also to American taxpayers, thereby placing an unnecessary burden on the U.S. dairy safety net.

NMPF is also greatly appreciative of the hard work that USTR and USDA staff, particularly in the Foreign Agriculture Service (FAS) and Chief Economist's Office divisions, do in securing and enforcing our rights in existing agreements. We have been actively engaged in a challenging situation with Mexico this year as the Mexican government significantly delayed issuing import licenses for dairy products it was obligated to provide access for under WTO and NAFTA commitments. USTR and FAS have worked diligently to ensure that licenses were issued and continue to monitor the ongoing situation.

Similarly, the Agricultural Marketing Service (AMS) has played a key role in facilitating the entry of our exports into foreign markets. Many countries impose challenging and varied labeling and SPS requirements on imports into their countries. The information and assistance that AMS provides in addressing these demands is vital to allowing our industry to take advantage of opportunities to grow our export markets.

All of this has been possible because Congress also passed Trade Promotion Authority in 2002. NMPF supported TPA because we believe that once a balanced agreement has been negotiated, it deserves an up or down vote based on its merits. It is up to USTR to negotiate the best possible agreement, with input from industry and members of Congress, naturally. Then dairy farmers, as well as members of Congress, can evaluate the final deal and determine whether or not it provides for the opportunity for balanced, two-way trade between the partner countries, before determining whether or not to support it.

A key point in maintaining continued support in the future for agreements that merit it, however, is ensuring that our rights and responsibilities under current trade agreements are properly pursued. Dairy farmers' experience with the utilization of the Dairy Export Incentive Program (DEIP) is a good case in point.

DEIP helps exporters of U.S. dairy products develop new markets and compete in markets where U.S. products are otherwise not competitive because of the presence of subsidized products from other countries. In 2001, we asked that the DEIP should be reauthorized at the maximum levels permitted within our export subsidy reduction commitments made during the Uruguay Round Agreement. Congress responded to this request and reauthorized DEIP as part of the 2002 Farm Bill.

Since then, USDA has done a good job of making use of the non-fat dry milk portion of DEIP in the years before U.S. domestic prices exceeded international prices for that product. Additionally, USDA frequently used the small allotment for cheese assistance. However, there have been times that NMPF would have preferred to see USDA make more aggressive use of this program, particularly for butter and, more recently, for cheese.

NMPF fully supports the complete elimination of export subsidies as part of the WTO Doha Round. However, so long as our trading partners continue to employ massive amounts of export subsidies to depress world prices, we support the continued use of the relatively modest assistance levels authorized to the U.S. under the current WTO agreement.

Finally, with respect to trade, NMPF supported the reauthorization and funding of the Market Access Program, and the Foreign Market Development Program (FMDP). This was ultimately included in the 2002 Farm Bill and we would hope that Congress will see fit to also include them in the next Farm Bill.

Federal Milk Marketing Orders

NMPF remains a strong supporter of the Federal Milk Marketing Orders. This system has evened the playing field for farmers and cooperatives for 70 years, and it has helped provided a fresh supply of milk to our consumers in a way unmatched by any other country in the world. Of course, it needs to adapt to remain effective, and USDA has been responsive to that need. Just last month, USDA issued a recommended decision in response to new milk-based drinks that compete with fluid milk, but do not pay the Class I milk price. USDA's decision will close a technical loophole and restore equity to fluid milk pricing. We applaud USDA's decision and quick handling of this issue.

Additionally, this spring, USDA stopped large bottling plants in two markets from using an exemption originally intended for small farmers who sold a wagon of milk a day. This decision complements the Milk Regulatory Equity Act, which Congress passed earlier this year, and ensures that these plants will compete in those markets on an equal basis with other plants and producers.

Federal Orders face new challenges every year, as the industry evolves; but we have confidence that USDA will meet those challenges, and the orders will evolve in step. While dairy farmers recognize that Federal Orders need to be refined, they do not need to be eliminated, as some others have proposed.

Cooperatives Working Together

As it has been demonstrated, Congress passed a Farm Bill that does not enhance producer income or increase the cost of products to consumers, but simply prevents further collapse of milk prices and establishes a reasonable safety net for producers. This is reflected in the fact that even with the Farm Bill programs in place, dairy producers in 2002 and 2003 received some of the lowest prices in 25 years for nearly a year. Subsequently, in July 2003, dairy producers started a program called Cooperatives Working Together to help strengthen and stabilize farm-level prices. Using the protections afforded farmers by the Capper-Volstead Act, we created a new marketing cooperative to voluntarily pool financial resources to pay for programs that reduce dairy supplies. The laws of economics being what they are, our supply-reduction activities have helped farmers improve their own livelihoods.

However, CWT is not a replacement for government safety net programs. It operates as a complement to, not a replacement of, federal farm programs. It's a unique program in agriculture, and we're very proud that farmers of all sizes, in all regions, have come together to cooperate and to help each other economically

Conclusion

In summary, NMPF believes that the Farm Bill signed by the President in 2002 was a reasonable, rational and fair approach to farm policy, from the perspective of dairy producers. Most of the items we asked the Senate and House Agriculture Committees to include in the bill found their way into it.

I will again remind the committee that we view farm policy holistically, and we believe so should the Congress. Even if the Agriculture Committee lacks jurisdiction on certain issues, we still feel that members of this Committee should weigh in on many of the critical issues of the day, such as trade policy, for instance. We commend the Chairman and Ranking Member for their leadership in this area.

When NMPF presented testimony to Congress concerning the 2002 Farm bill, there were 83,000 dairy farmers in the U.S. Today, there are about 60,000. Despite this decline in the number of farmers, ours is a growing industry in terms of production and one which we believe has a bright future in America. Despite the evolving nature of our industry, virtually all of those 60,000 dairy farms are family owned, and dairy products remain an important and nutritious staple of Americans' diets.

At the same time, however, government farm policy plays a key role in creating the environment and policies under which rural American can flourish. That's why the Farm Bill is so important.

Our message to the Senate is that dairy farmers are not looking for a handout. Nor are we looking for a hand up; what farmers are looking for from government is a handshake. Dairy farmers want a sign of commitment such as a handshake indicating, when times are tough, that there will be a modest safety net in place to help catch those who are vulnerable. NMPF takes comfort in knowing that members of this Committee realize the tremendous impact that the Farm Bill has on U.S. agriculture and looks forward to working with Congress when it is ultimately time to collaborate on drafting the next Bill.

Statement of Jim Green

President & CEO

Kemps LLC, Saint Paul, MN

Before the Senate Committee on Agriculture, Nutrition & Forestry

Thursday, July 20, 2006

Washington, DC

Mr. Chairman and members of the Committee, I am Jim Green, President & CEO of Kemps LLC, a Saint-Paul, Minnesota based company that makes and markets milk, ice cream, cottage cheese, sour cream, dips and yogurt. Kemps is a wholly-owned subsidiary of H.P. Hood, LLC, one of the largest dairy companies in America.

Thank you for the opportunity to participate in this hearing and offer my perspective about our nation's dairy industry. I have been in the dairy business my entire life, starting with a family owned operation in York, Pennsylvania. Today, I have the privilege of working at Kemps and chairing the International Dairy Foods Association (IDFA) and the International Ice Cream Association (IICA).

Mr. Chairman, the long term prosperity of our dairy industry depends on reasonable policies that ensure a viable domestic milk production and allow all segments of the industry to benefit from selling more dairy products here at home and abroad. Meeting these objectives may sound simple; but outdated policies stand in the way of markets working most effectively and a legacy of short term "fixes" to address temporary farm price declines are keeping these opportunities out of reach. We are a vastly different dairy industry today and we require vastly different dairy policies to help us succeed.

U.S dairy policies have been altered very little since they were created in the 1930's and 40's despite years of structural change to our industry. Seventy years ago, milk was used principally for fluid consumption, markets were concentrated locally and many dairy operations were a small part of diversified farms. Fast forward seventy years, and consumption of cheese, not fluid milk, is the major use for farm milk. US dairy products are marketed nationally and globally, milk is produced efficiently in areas not considered dairy country in the 1940's, and most U.S. dairy farms are highly specialized operations. In fact, 50% of all U.S. milk production today comes from the 4% of dairy farms with 500 or more milk cows, compared to the 1950's when 93% of the milk came from farms with less than 50 cows. While dramatic shifts in production, manufacturing and consumption have occurred, most of the policies enacted in the 1930's and 40's have gone largely untouched. Although the basic structure of U.S. dairy policy remains rooted in a 1940's mindset, Congress has layered on new government policies along the way leading to unintended and undesirable consequences.

Mr. Chairman, the outmoded dairy policies of today are preventing U.S. dairy producers and processors from taking full advantage of new opportunities here and abroad. Dairy processors across the country support a safety net for dairy farmers. However, we believe the current set of programs is failing the industry and consumers. Dairy policies must change if we have any hope of becoming the leading world supplier of high quality, competitive dairy products. In theory, the process of getting milk from the cow to consumers should be simple, but the reality of current government milk pricing regulations and support programs is as far away from simple as you can get. As the attached chart shows, the complex system can truly be called Byzantine. I will attempt to illustrate some of the failings of existing dairy programs in my testimony today by starting with the oldest, the Federal Milk Marketing Orders.

Federal Milk Marketing Orders

The intent of the Federal Milk Marketing Order (FMMO) system when Congress created it in 1937 was to ensure the availability of an adequate supply of high quality farm milk to meet consumer needs for fluid milk beverages. The primary elements of this system are classifying farm milk according to the products it is used to make, setting minimum prices for each class of milk, and pooling the receipts from all milk processors in a marketing area so that each dairy producer receives the same weighted average price. I would like to pause here and point out that no other agriculture commodity has a classified pricing system today. The system was designed to solve problems that existed in the 1930's but do not exist today. More concerning is the fact that experts say this system contributes directly to ever declining per capita consumption of fluid milk due to its higher regulated price, and exacerbates regional differences in farm milk prices.

Let me explain why this system is so outdated. 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, and other "soft" products), Class III (cheese), and Class IV (butter and dry milk powder). Producers in a federal order area are paid a "blend price", which is the weighted averaged combination of the class prices paid in their marketing area. This classified pricing scheme was aimed at providing an incentive to produce and process high quality or, what is called, "Grade A" milk. This may have been necessary in 1937 when less than 40% of all farm milk was Grade A. But for the last 10 years, more than 99% of all milk produced in the U.S. is Grade A, and that will not change given our strict food safety standards and consumer demands. Clearly, the simple and laudable goal of the 1930's to ensure a sufficient supply of Grade A milk to serve all consumer needs for fluid milk products has been met by the marketplace and this complex scheme has outlived its usefulness.

Mr. Chairman, did you know that USDA assigns every one of the 3,067 counties in the U.S. with its own Class I minimum price? This regional pricing of Class I milk is another complicating facet of federal orders. However, technological advancements in refrigeration, transportation and distribution have completely changed the world and 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 coast to coast distribution and marketing. Companies like Kemps are striving to serve this national marketplace in spite of the obstacles created by this outdated federal pricing system.

One consequence of this complex price regulation is regional distortions in farm milk prices. An area such as Florida, for example, with the highest Class I minimum price and the highest percentage of Class I milk use (over 85%) has a greater dollar value to share among its producers. Conversely, areas such as the Central and Upper Midwest orders where there is a lower Class I minimum price and a much greater percentage of farm milk used to make cheese see very little gain from classified pricing and pooling.

These differences were exacerbated by changes made in the Federal Milk Marketing Order program as a result of the 1996 Farm Bill which 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. These regional distortions built into the regulations -- whether they are price enhancing or depressing -- should be eliminated. Markets can better sort out prices needed to match supply with demand than government regulations.

Contrary to its original intent in the 1930's, the system's emphasis on a higher regulated Class I minimum price is actually hurting consumption of fluid milk products in the U.S. Since 1975, dairy farmers have increased farm milk production by more than 50%, an increase of over 60 billion pounds of milk. During the same period, the population in the United States increased by over 40%. Unfortunately, total fluid milk sales increased by less than 0.1%. In fact, only eight million more pounds of fluid milk are sold today than in 1975. Continuing to mandate a higher price for the dairy product experiencing the greatest decline in per capita consumption is not helping our dairy industry.

Congress has tried to address the problems with the current system over the years. In 1985 and 1996, Congress attempted to alter the operations of federal milk marketing orders, but these actions only increased regional differences in regulated milk prices, fostering regional dairy divisiveness which continues today. In the 1996 Farm Bill, Congress assigned USDA the technically demanding task of deciding which federal order regulations to change. However, after a three year process, Congress intervened and overturned some, but not all, of USDA's proposed changes. Consequently, there are larger distortions in regional farm milk price relationships now than had ever occurred previously and regional divisiveness prevails.

The resulting federal milk marketing order system keeps the dairy industry at a competitive disadvantage in today's marketplace. Seventy years ago, milk was unrivaled as the beverage of choice. Today, milk competes with bottled water, fruit juices, soft drinks, teas, sport and energy drinks; none of which are subject to such government-run classified pricing schemes. Globally, only America and Canada still maintain rigid milk price setting regulations while our competitors, like New Zealand and Australia, have ended such regulations. Even emerging international dairy markets, such as Russia, China and India have avoided the "American model." Ironically, these socialist countries have freer dairy markets than we do. These facts are all clear indications that we need to change the way we do business in America.

We need a system that is more market-oriented. <u>Congress should begin the transition by limiting USDA's interference in manufacturers' business decisions by streamlining the rigid and vastly complex process used to amend federal milk marketing orders</u>. This process dictates most of the parameters under which the dairy industry is forced to operate and has become inflexible and unresponsive to on-going structural changes in the industry. As a result, not only are the rules governing every aspect of dairy pricing out of touch with reality, but USDA is creating regulations that force many companies to make business decisions based on government regulations instead of market realities. This situation is potentially crippling to our industry.

The most recent example of this frustrating system is USDA's failure to update much needed cost adjustments in federal order pricing formulas in a timely fashion. Last year, dairy cooperatives and private companies came together to petition USDA for an emergency hearing to try to get a simple update of cost data used to calculate "make allowances" -- adjustments for the cost of turning raw milk into a finished dairy product. The current make allowances were set using cost data from 1997-1999. In January, 2006, USDA conducted four days of hearings on this very narrow issue. Cost information was provided at the hearing from precisely the same sources as had been used to establish the current make allowances. Despite the clear need for action to update these formulas, USDA has inexplicably delayed a decision indefinitely.

Because of the classified pricing scheme, dairy manufacturers are dependent on USDA for urgent relief and every month of delay means manufacturers of cheese, dry whey, butter and nonfat dry milk are losing at least $26 million due to the failure to update the make allowances. Congress certainly never intended to threaten the economic viability of the U.S. dairy industry by forcing manufacturers to lose money on every pound of cheese or other product made when it approved the creation of make allowances. Dairy manufacturers have asked USDA to provide some relief through an interim update of costs included in these price formulas. Unfortunately, this is one of many examples of how this Depression Era system is panning out to be one of the most disorderly, disruptive and disjointed schemes ever foisted on an industry.

So long as the federal milk marketing order system is allowed to exist, the process for making decisions should be streamlined and clear and timely deadlines for action imposed. Such steps begin the transition to a more responsive system and prepare dairy producers, processors and cooperatives for a time when markets, not government regulations, will drive decision-making.

Dairy Price Support Program

Another dairy program that inhibits innovation and growth is the dairy price support program, which dates back to the 1949 Farm Bill. The program is intended to be a safety net for dairy producers by requiring USDA's Commodity Credit Corporation (CCC) to maintain the price of milk used for manufactured dairy products at a national average of $9.90 per hundred weight. The CCC attempts to achieve this goal by purchasing nonfat dry milk, butter, and cheese at established prices. These purchased commodities are then stored, sold or donated. Between 2000 and 2004, the federal government spent an average of $517 million a year maintaining the dairy price support program.

Once again, dairy is the only commodity with this type of system. According to Office of Management and Budget's recent evaluation of the program, the dairy price support program maintains milk prices above the mandated support price, but is inefficient because the expenditures continue at times when manufacturing milk prices are well above support.

Congress voted to phase out the dairy price support program in 1996 because of high budget costs and its limited utility for actually assisting farmers. At that time, the industry supported this phase out to occur by December 31, 1999, and be replaced with a non-recourse loan program to provide an ongoing safety net. This historic step was undone, however, as legislators extended the program several times until the 2002 Farm Bill, when the price support program was reinstated and the non-recourse loan program eliminated.

But the past performance of this program has not validated its continued existence and Congress should once again question whether this program needs to exist. For example, beginning in 2000 (after the program was no longer supposed to exist), USDA purchases of nonfat dry milk created a literal mountain of government-owned milk powder, and forced USDA to create new market distorting programs to dispose of this surplus. The nonfat dry milk disposal programs may have finally eliminated the mountain of government stocks, but they wreaked havoc on dairy markets. For example, USDA attempted to help livestock producers during times of financial stress by providing nonfat dry milk for feed, but this move devastated a long standing market for dry whey products, also used for animal feed. The unintended consequence of this nonfat dry milk give-away program was lower market prices for whey, which led to lower farm milk prices overall - the very result the dairy price support program was designed to prevent.

USDA has tried to control costs on its own with only minimal success. In June 2001, USDA adjusted the purchase prices for nonfat dry milk and butter under the dairy price support program, but 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. Despite these steps, USDA still spent $1.3 billion in 2002-2004 to purchase surplus nonfat dry milk and they did so at a time of rebounding farm milk prices. Congress should put rules in place to govern government expenditures under this program.

The program was intended to be a safety net for dairy producers, but over time, it has become a program that encourages continued production of certain products, particularly nonfat dry milk, instead of allowing market signals to drive production to more valuable dairy proteins that enjoy growing demand in a wide variety of products. The Office of Management and Budget reached this conclusion in its February 2005 assessment of the dairy price support program. In its report, OMB found that "the price support program has resulted in large, costly stocks of skim milk powder, and has contributed to an oversupply of dairy capacity in certain regions and in certain dairy product categories, discouraging private investment in dairy products that are currently imported (such as [milk protein concentrates]). Other agricultural support programs demonstrate ability to support income and production capacity with fewer market distortions and less cost." This evaluation was echoed by the International Trade Commission (ITC). In a May 2004 report to Congress, the ITC found that "U.S. government support for SMP [skim milk powder] reduces the incentives to produce MPC and casein in the United States." The ITC went on to say that "U.S. production of these products is limited, and likely to remain limited, so long as the current Federal Milk Marketing Order and Dairy Price Support Program prices remain in effect."

The bottom line is that the U.S. is not a world leader in the production of value-added dairy proteins like milk protein concentrate and casein because the federal dairy price support program makes it more profitable for companies to sell nonfat dry milk powder to USDA than to invest in technology to make milk proteins demanded by the market. And, until Congress rectifies this situation, the U.S. will not be able to compete adequately in today's global dairy trade.

I applaud the Bush Administration for taking the first step in recognizing that the dairy price support program needs to change. In the 2006 and 2007 Bush Administration budget proposals, the President sent Congress legislative language designed to minimize the negative impacts of the dairy price support program on both dairy markets and government outlays. I strongly encourage you to consider this modest change in the program as a first step to reducing the program's market distorting effects. The Congressional Budget Office estimates this small adjustment will save taxpayers nearly a quarter of a billion dollars over five years in unnecessary government expenditures. We believe the Administration's proposal to administer the program more efficiently is surely the minimum that can be done to bring more discipline to the program.

Milk Income Loss Contract Program

The third program designed by Congress to support dairy producers is the Milk Income Loss Contract (MILC) program. This program does not date back to the 1930s and 40s, but instead is one of the new government dairy programs layered on top of federal orders and the dairy price support program. MILC is a direct payment program which calculates a payment rate based on the difference between a target price and the market price for farm milk and pays producers when the market prices falls below the target. This payment rate is then multiplied by the milk production sold from each farm up to a payment limit to determine the monthly subsidy check written by USDA. The program resembles other federal agriculture direct payment programs.

However, like all programs in dairy, this program is unique and unfortunately not ideal. Congress never intended this program to last. It was put in place as a transition from the failed Northeast Interstate Dairy Compact. Congress recognized early on how expensive the MILC program would be by only authorizing payments between December 2001 and September 2005 when it was created in the 2002 Farm Bill. With the inclusion of MILC in the Budget Reconciliation bill earlier this year, MILC supporters secured an extension of the program from October 2005 to September 2007, while nearly every other commodity program was cut.

I applaud you, Mr. Chairman, for having this hearing, as Congress has never held one hearing or conducted one in-depth examination of the MILC program. If it had, you would have found that the MILC program is expected to cost nearly three times more than originally estimated by the Congressional Budget Office. At a time when lawmakers are being asked to make tough choices to cut funding for USDA feeding and commodity support programs in the next Farm Bill, Congress again will be asked to extend this program and it should think twice before doing so.

In a comprehensive October 2004 study of dairy programs, USDA reported that MILC conflicts with the dairy price support program and actually decreases milk prices paid to producers. The two programs simply cannot coexist effectively. According to USDA, without the MILC program, "the remaining dairy programs raise the all-milk price (the price paid to farmers) by 4%, compared to about 1% with MILC, on average over five years." The bottom line is that continuing the MILC program keeps farm milk prices lower for longer periods of time. Through September 2005, USDA reported over $2 billion in MILC payments were made to dairy producers. During this same period, USDA also spent $1.5 billion purchasing dairy products, mostly nonfat dry milk, under the dairy price support program. The Congressional Budget Office estimates that the two-year extension of the MILC program through September 2007 will cost an additional $1 billion.

As you look at the future of this program, Mr. Chairman, I would urge you to recognize that the MILC program is not a true, national safety net but one that has resulted in costly government outlays and fanned regional divisions, pitting dairy producers against dairy producers. First, Congress set the target price well above the average milk price in recent years. So, MILC acts more like an income enhancement program than a true safety net program. For example, USDA made MILC payments to dairy producers during four months in 2004 (January - April), a year in which farm milk prices reached record levels. Second, Congress mandated a very strict payment limit provision, so that only farm milk sales up to 2.4 million pounds of milk are eligible to receive payments. In months when payments are made, estimates are that, on average, less than 45% of all U.S. farm milk production is eligible to receive a payment due to the low production cap.

However, the greatest dilemma is the inherent conflict between the MILC program and the dairy price support program. The government, through the MILC program, pays some dairy farmers to produce more milk, and then turns around through the dairy price support program and buys the excess milk in the form of nonfat dry milk, butter and cheese -- essentially paying twice for the same milk. USDA reported this fact in a 2004 report, in which it noted: "When the market price has fallen toward the price support safety net and thus is calling for an adjustment in supply, the results are partially muted by the MILC program, which, by providing production-linked funds to milk producers, may encourage production and retard the supply adjustment. The result is that milk prices stay lower longer than they otherwise would, increasingly the likelihood of larger CCC purchases, and raising costs for both programs." By allowing these two conflicting dairy subsidy programs to operate simultaneously, the federal government prevents markets from clearing properly, artificially interferes with the commercial marketplace and does very little to help dairy farmers. Mr. Chairman, I think one of your greatest challenges in the Farm Bill will be to reconcile these two programs and eliminate the less effective of the two.

Dairy Export Incentive Program

As we look to reconcile the conflicts in our domestic program, we cannot forget that we sell U.S. agriculture commodities in a global marketplace. The U.S. dairy industry had developed a significant export market when support prices were maintained at market clearing levels. In the 1986 Farm Bill, the Dairy Export Incentive Program or DEIP was created to make the U.S. dairy industry competitive with subsidized exports from other countries, but in particular the European Union.

It is important that Congress take a look at the DEIP program to ensure that government interventions such as DEIP are managed to achieve their export market goals without causing significant distortions in domestic markets. For instance, over 40 million pounds of butter were 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 US dairy products using high butterfat ingredients such as ice cream. 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.

I now want to touch on two programs in dairy that you should be aware of - one that should not be enacted and one that must be enacted.

Dairy Import Assessment

In 2002, Congress included a provision in the Farm Bill to extend an assessment used to fund domestic generic promotion activities to any dairy product imported into the United States. The Farm Bill provision also mandated that administration of the import assessment must be consistent with exiting international trade obligations. Since 1984, U.S. dairy farmers have elected to fund a generic dairy promotion program by voluntarily assessing themselves $0.15 per hundredweight of milk sold to be used to promote consumption of fluid milk and other dairy products in the United States.

After passage, USDA and the U.S. Trade Representative determined that implementing the assessment language was not possible without breaching U.S. obligations under the World Trade Organization. Congress should repeal the 2002 language and look for other ways to help promote the consumption of dairy products.

Dairy Forward Pricing Pilot Program

As we have discussed, the price of milk has been a central focus of many dairy policy decisions. We believe Congress can better help all dairy farmers manage the price they receive for their milk by re-enacting the Dairy Forward Contracting Pilot Program. I appreciate the opportunity today to discuss the benefits of this program with you.

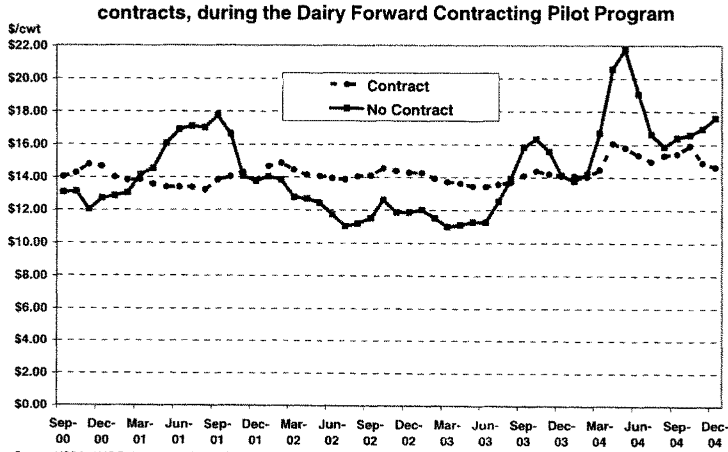
The Dairy Forward Contracting Pilot Program existed from 2000-2004 and allowed independent milk producers and cooperatives to negotiate a mutually agreeable price with processors for Class II, III, and IV milk. After the program expired and prior to its existence, dairy cooperatives and their producer members were the only dairy businesses allowed to negotiate a mutually agreed upon price that may or may not be based on the milk marketing order minimum price.

We believe, like in other agriculture industries, all farmers should have the right to forward contract. USDA reported the positive effects of the pilot program and supported legislation to convert the successful pilot into a permanent program. According to the 2002 USDA report, the pilot program achieved its primary objective as a risk management tool for farmers by creating greater price stability for producers who contracted their milk than those who did not.

As you know, Mr. Chairman, the real test of a risk management tool is how well it helps reduce price volatility. In this regard, the pilot program was an undisputed success. Dairy farmers across the country forward contract their input costs. They should be able to forward contract their milk. Many who belong to cooperatives are still taking advantage of this important risk management tool, and we think everyone in the dairy industry should have that right, too.

As a risk management tool, dairy forward contracting should be evaluated by looking at its ability to reduce price volatility over time. As the following chart shows, dairy farmers with forward contracts under this pilot program received milk prices ranging from $13.23 to $16.06; a range of less than $3.00 per hundredweight. Had these farmers not used this risk management tool, the milk price they received during this period would have varied from $11.00 to $21.80, an enormously volatile range of $10.80 per hundredweight.

Milk prices received by farmers, both with and without forward contracts, during the Dairy Forward Contracting Pilot Program



Source: USDA, AMS Dairy Forward Pricing Pilot Program: Information for the Complete Program Periods, September 2000 through December 2004.

Over the four year period, all dairy farmers whether they belonged to a cooperative or not had unencumbered access to this popular risk management tool. As you know, forward contracting is the risk management tool most frequently used by farmers outside the dairy sector. A majority of farmers use forward contracting to lock in the prices they receive for cotton, corn and wheat. Dairy farmers often utilize forward contracts to lock in feed, fuel and other input costs. Unfortunately, since this successful program was allowed to expire, independent dairy farmers no longer have the ability to use this tool like their counterparts who market their milk through cooperatives.

Some argue that if this program is made permanent it will cause the Federal Milk Marketing Orders to collapse. While opponents of the program might wish that to be the case, this is simply incorrect. The federal order system did not crumble during the years the pilot program existed. These same naysayers may also argue that processors who forward contracted are not required to participate in the Federal order pooling requirements but USDA rules governing this program clearly state that participating processors were required to pay into the producer fund or "pool" just like other regulated processors. We believe reinstating this program is about leveling the playing field. This program gives producers and processors the ability to hold their future in their own hands and not rely on government programs or arcane regulations to ensure their livelihood. Importantly, this program would provide a valuable tool for the industry with no government costs.

Congress should restore the dairy forward contracting program and level the playing field by making this tool available to all dairy producers and processors who use milk to manufacture dairy products, such as cheese, yogurt and ice cream.

Other Programs Available for Dairy Producers

When considering overall government support of dairy producers, it is important to remember that other programs besides direct commodity assistance programs provide benefits to dairy producers. Conservation, environmental and animal health programs help reduce costs and enable farm improvements for dairy producers. Other assistance, like disaster relief, provides immediate help in times of crisis. As you wrestle with the multiple layers of dairy subsidy programs, I urge you to consider those programs aimed at the entire farming community that also benefits dairy producers. These programs can provide benefits to dairy farmers far beyond the limitations of direct payments, price supports or classified pricing schemes because they directly address pressing environmental, conservation and animal health issues. Here are some of the specific programs used by dairy producers:

Conservation & Environment

Environmental Quality Incentive Program (EQIP) makes funds available to dairy operators to apply practices related to waste handling and nutrient reduction to surface and ground water resources. Since the 2002 farm bill, 60 percent of this program's fund must go to animal agriculture – including dairy.

Conservation Technical Assistance (CTA) is a voluntary program that provides technical assistance and tools to help people conserve, maintain, and improve their natural resources. Dairy farmers use it to manage fertilizer use of manure, control soil erosion, and other management practices.

Conservation Security Program (CSP) offers payments for good environmental practices. In the case of dairy, it applies to livestock feeding and handling areas, especially with regard to leaks in pipelines, manure storage, or transfer facilities and proper disposal of livestock mortalities.

Agricultural Management Assistance (AMA) program which provides assistance for a variety of activities related to farm management was expanded. Agricultural Management Assistance (AMA) provides cost share assistance to agricultural producers to voluntarily address issues such as water management, water quality, and erosion control by incorporating conservation into their farming operations. Producers in certain "underserved" states may even use funds from this program for economic and price risk management activities.

Conservation Reserve Program (CRP) pays rental rates on land set aside for conservation purposes. Dairy farms use the program to offset the costs of creating buffer zones, maintaining riparian areas, and establishing grass filter strips especially where streams and other water resources are potentially impaired by cattle.

Wildlife Habitat Incentive Program (WHIP) is a voluntary program for people who want to develop and improve wildlife habitat primarily on private land. Through WHIP, technical assistance and up to 75 percent cost-share assistance to establish and improve fish and wildlife habitat is offered. Dairy farms are eligible.

According to USDA, $376.5 million in conservation payments were paid to dairy producers in 2004. We urge Congress to continue encouraging dairy producers to take advantage of these programs as a more suitable way to support and sustain our dairy producing community.

<u>Emergency Assistance</u>

As a whole, the dairy processing industry believes our government should help farming communities in times of need. According to the Library of Congress, "32 appropriations, authorization, or farm disaster acts added approximately $54.4 billion in supplemental spending" to support farm income. Dairy farmers are eligible for funds in these payments. In some instances, there are express set-aside amounts for dairy producers, as shown below:

Legislation	Dairy Provision
1998 Supplemental Appropriations and Rescissions Act	$4 million for the Livestock Indemnity Program; and $6.8 million for dairy farmer disaster payments.
Omnibus Appropriations Act 1999	$3.057 billion (of a total $5.8 billion package) in "market loss payments" made expressly to "grain, cotton and dairy farmers" in response to low farm commodity prices.
Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, FY2000	$125 million for dairy producers and a one year extension of the dairy price support program.
Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, FY2001	$675 million in income assistance payments to dairy farmers;
Military Construction Appropriations and Emergency Hurricane Supplemental Appropriations Act, 2005	$10 million for dairy production losses and spoilage caused by a 2004 hurricane;

A $4.2 billion disaster relief package was also recently included in the Senate's 2007 Agriculture Appropriations bill; it ear-marks $147 million for dairy farmers. ***Livestock Compensation Program*** (LCP) was implemented by USDA in 2002 and 2003. Under the LCP, USDA made payments to all producers of beef, dairy, sheep, and goats in any county that was declared a disaster area by the Secretary between January 1, 2001, and February 20, 2003, regardless of the individual producer's loss experience. The program was not specifically authorized by Congress but was initially implemented by USDA under existing authorities, and later supplemented with funding provided in the FY2003 omnibus appropriations act (P.L. 108-7).

Dairy Indemnification Program authorizes USDA to make indemnification payments to dairy producers who are forced to move their products from the commercial markets for some reason beyond their control.

Emergency Conservation Program (ECP) provides funds to farmers and ranchers for sharing the cost of rehabilitating farmland damaged by natural disasters, and for carrying out water conservation measures during severe drought. It is permanently authorized by Title IV of the Agricultural Credit Act of 1978 (P.L. 95-334), subject to annual appropriations.

Animal Health

Johne's Disease Control Program helps dairy farmers cope with Johne's disease, a contagious and usually fatal disease affecting dairy cows. The 2006 National Voluntary Johne's Control Program was funded at $13.2 million to run testing programs in 43 states.

New Directions for Dairy Policy

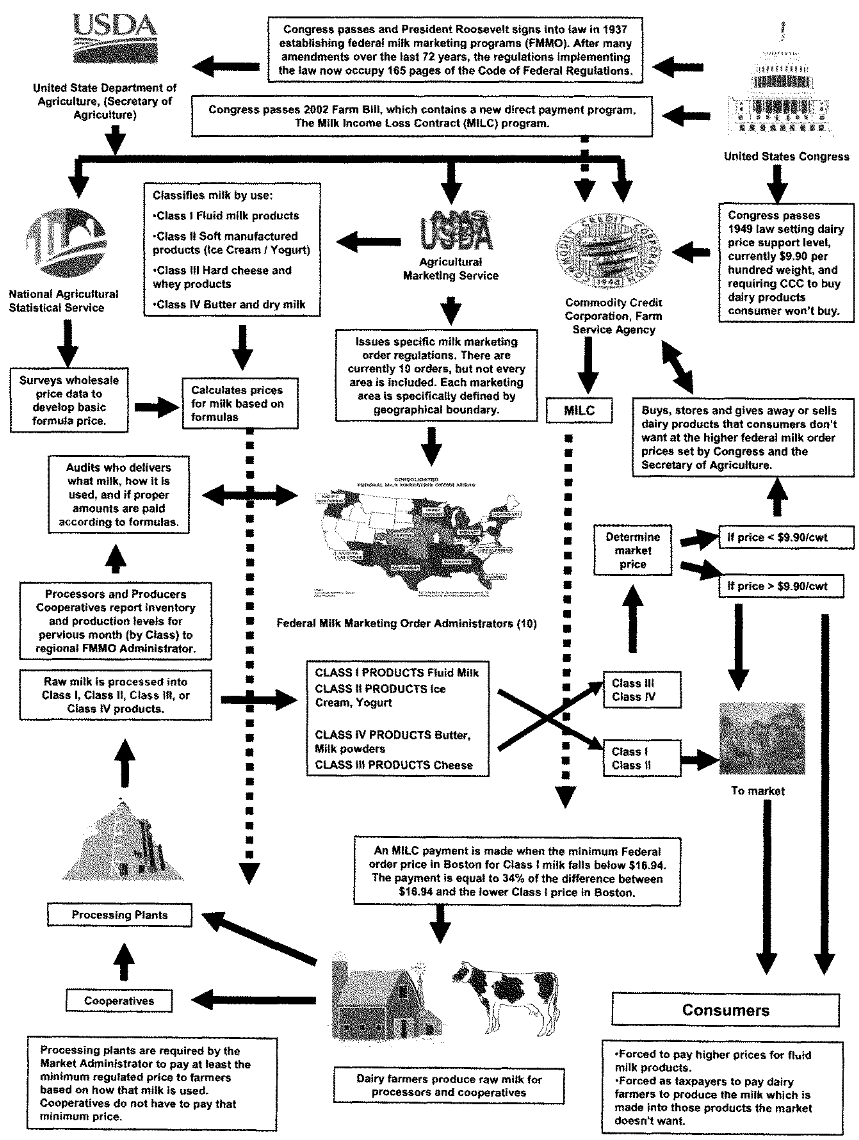
Congress has been responsive to the needs of dairy producers in the past, but the time has come to take a closer look at ways Congress can help the entire dairy industry by validating programs that address the needs of today's dairy industry instead of those from a bygone era.

In order to seize opportunities here and abroad, we need Congress to update and improve our dairy policies with small, meaningful steps to put us on the right track to future success. As we look to the future, there is enormous potential for U.S. dairy producers and processors. The next Farm Bill provides an opportunity for Congress to begin this transition. From our perspective, this can best be accomplished by:

- Initiating a transition from our current set of support programs to a single, national safety net for dairy farmers that provides critical assistance when needed, yet minimizes market interference, is fiscally responsible and complies with our trade goals and obligations;
- Creating a more level playing field for all producers and processors to compete fairly and equitably in today's volatile dairy markets by providing permanent authority for forward contracting for Class II, III & IV milk;
- Providing assistance for farm investments that will help the environment and contribute to responsible land conservation; and,
- Making the federal milk marketing order process more flexible and responsive.

Mr. Chairman and members of the Committee, the dairy processing industry 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.


USDA
United State Department of Agriculture, (Secretary of Agriculture)
Congress passes and President Roosevelt signs into law in 1937 establishing federal milk marketing programs (FMMO). After many amendments over the last 72 years, the regulations implementing the law now occupy 165 pages of the Code of Federal Regulations.
Congress passes 2002 Farm Bill, which contains a new direct payment program, The Milk Income Loss Contract (MILC) program.
United States Congress
National Agricultural Statistical Service
Classifies milk by use:
•Class I Fluid milk products
•Class II Soft manufactured products (Ice Cream / Yogurt)
•Class III Hard cheese and whey products
•Class IV Butter and dry milk
AMS USDA
Agricultural Marketing Service
Commodity Credit Corporation, Farm Service Agency
Congress passes 1949 law setting dairy price support level, currently $9.90 per hundred weight, and requiring CCC to buy dairy products consumer won't buy.
Surveys wholesale price data to develop basic formula price.
Calculates prices for milk based on formulas
Issues specific milk marketing order regulations. There are currently 10 orders, but not every area is included. Each marketing area is specifically defined by geographical boundary.
MILC
Buys, stores and gives away or sells dairy products that consumers don't want at the higher federal milk order prices set by Congress and the Secretary of Agriculture.
Audits who delivers what milk, how it is used, and if proper amounts are paid according to formulas.
Federal Milk Marketing Order Administrators (10)
Determine market price
If price < $9.90/cwt
If price > $9.90/cwt
Processors and Producers Cooperatives report inventory and production levels for pervious month (by Class) to regional FMMO Administrator.
Raw milk is processed into Class I, Class II, Class III, or Class IV products.
CLASS I PRODUCTS Fluid Milk
CLASS II PRODUCTS Ice Cream, Yogurt
CLASS IV PRODUCTS Butter, Milk powders
CLASS III PRODUCTS Cheese
Class III
Class IV
Class I
Class II
To market
An MILC payment is made when the minimum Federal order price in Boston for Class I milk falls below $16.94. The payment is equal to 34% of the difference between $16.94 and the lower Class I price in Boston.
Processing Plants
Cooperatives
Consumers
Processing plants are required by the Market Administrator to pay at least the minimum regulated price to farmers based on how that milk is used. Cooperatives do not have to pay that minimum price.
Dairy farmers produce raw milk for processors and cooperatives
•Forced to pay higher prices for fluid milk products.
•Forced as taxpayers to pay dairy farmers to produce the milk which is made into those products the market doesn't want.

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Testimony of Ken Hall
Dairy Producer
Terreton, Idaho

Before the United States Senate Committee on Agriculture, Nutrition and Forestry
Washington, DC

July 20, 2006

Mr. Chairman and members of the Committee, my name is Ken Hall. I am a dairy producer from Terreton, Idaho and I am before you today representing myself and also the Idaho Dairymen's Association (IDA). IDA was formed as a dairy producer advocacy group in 1944 and has a dairy producer board of directors that is elected by their peers. All dairy producers in Idaho are members of IDA and pay a $0.001/cwt assessment to cover the cost of the organization.

I began working in the dairy industry in 1979 by managing dairy operations for the Church Of Jesus Christ Of Later Day Saints in Idaho, Utah and Maryland. From 1989 to 1993 I managed Masstock Dairy, a 3500 head operation located in Georgia. In 1993 my wife, Carol, and I started Hall Dairy, LLC and we started our own operation in Terrreton, Idaho with 100 cows. Today we are milking 2000 head.

The upcoming farm bill debate should be utilized as a time of review to determine the long-term effectiveness of agricultural programs. Since the 1930's the government has attempted to assist agricultural producers by replacing the "signals" of the market that would impact price by keeping supply and demand in check with government "signals".

If the intent of the government "support" programs is to provide an adequate return on time and investment, then the outcomes show that the programs have failed. In 1981 the Class III price, which is the basis for all milk pricing, and presently the high water mark for pricing in Idaho, averaged $12.57/cwt. In 2000 it averaged $9.74 and in 2004 it averaged $15.39. For the 48 months representing 2000 to 2003 40% of the time the monthly Class III price was below the $9.90 support price with November of 2000 dipping all the way down to $8.57. This extreme volatility and pricing that is lower than prices producers received over 30 years ago is a direct result of failed government programs that do not allow the market system to work. The same results can be seen in the corn market the average price per bushel in 1981 was $2.92 today that same bushel sells for $2.40.

How do agriculturalists survive? They expand by planting more acres or milk more cows, and adopt technology that increases yields. Those who can't adjust leave the business. Since 1981, commercial dairies, those with licenses to sell milk, have been reduced from 225,000 to 64,000, a 72% reduction. This begs the question, are the government dairy support programs working? The short answer is "no."

An example of such a program is the Milk Income Loss Contract (MILC). I believe that it interferes with the free market system by sending false market signals. It also interferes with other government dairy price support programs, and discriminates against producers and their operations based on size. In the 2004 United States Department of Agriculture (USDA) "Economic Effects Of US Dairy Policy and Alternative Approaches To Milk Pricing" Report to Congress stated that "there is a basic incompatibility" between MILC and other pre-existing dairy-subsidy programs.

The Agriculture Department found that MILC does in fact artificially depress the price of milk by encouraging overproduction. "The price support program and the MILC program provide an example of problems that can be caused by conflicting policy outcomes." In reality, MILC distorts the market and conflicts directly with other pre-existing subsidy programs all at a cost close to $2 billion since its inception, nearly twice the $1 billion originally budgeted for it.

The milk price-support program, which dates to the Depression-era Agricultural Adjustment Act, should also be reviewed to determine if it is fulfilling its purpose as intended or inhibiting the market system to function. Under that program, the government steps in and buys dairy products when the price falls below a certain level. If that support price is set low enough, it provides some income security to farmers while allowing the market to slowly clear and production to fall to the point where prices can rise again. It is our belief that the program no longer serves its stated purpose and allows the price of milk to stay low for an extended period of time, longer than if the market system was allowed to function without government interference. As I stated above many times since 2000 the Class III price dropped below the support price. When this occurs, the pay price for Idaho producers both when we were in a Federal Milk Marketing Order (FMMO) and now that we are no longer a part of a FMMO, drops below support.

As stated above Idaho Dairymen's Association represents all of the dairy producers in Idaho and although Idaho is viewed as a large dairy producer state over 49% of our producers milk 200 cows or less and receive full benefit of the MILC program. Due to that fact, we studied the MILC program thoroughly before coming to a position of opposition. Utilizing the factual data presented by both USDA and agricultural economist we struggle to understand why those who have the best interest of dairy producers in mind, including members of this esteemed committee and farm organizations, would continue to support dairy programs that have failed the industry.

One tool that I would encourage including in the 2007 Farm Bill is permanent authority for all dairy producers to use forward contracting. Simply put dairy forward contracting provides price stability by allowing dairy producers to manage risk. USDA tracked performance during the 2000-2004 pilot program and found that forward contracts were effective in achieving stable prices.

Utilizing forward contracts, dairy producers can service debt more easily, obtain more favorable financing, expand their operations and guarantee a margin above the cost of production. Dairy producers deserve to have a tool that provides them with the freedom to price every pound of milk they sell before it is produced.

Forward contracting is extensively utilized by other commodities, even those with government support programs, because it allows the buyer and seller to mutually agree on an advance price so they can have a more predictable basis for planning their investments, financing needs and growth.

Congress provided the necessary tools for agriculturalist to control their destiny in February of 1922 with the adoption of the Capper-Volstead Act. The Act, as you're aware allows producers the freedom to work together. National Milk Producers Federation has taken the lead in the formation of Cooperatives Working Together (CWT). The program, which is producer funded, is an example of the Capper- Volstead functioning as intended. Although approximately 50% of the milk produced in Idaho is marketed directly to processors and not through cooperatives 84% of the milk produced in the state is participating in the self help program.

It is our estimation that the elimination of government-sponsored agriculture programs would allow the free market system to work with producers being protected through the ability to work together under the protection of the Capper-Volstead Act.

I greatly appreciate this opportunity to testify before you. Thank you.

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Testimony
By
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St. Albans, Vermont

Review of U. S. Department of Agriculture Dairy Programs

U. S. Senate Committee on Agriculture, Nutrition and Forestry

July 20, 2006

I am Leon Berthiaume, General Manager/CEO, of St. Albans Cooperative Creamery, Inc. located in St. Albans, Vermont.

It is a pleasure to have the opportunity to submit written testimony and participate in the hearing process as a member of a panel to review the United States Department of Agriculture Dairy programs.

I would like to thank Chairman Chambliss and Senator Patrick Leahy and members of the Committee for their leadership, commitment and support for agriculture; specifically the dairy industry.

I had the privilege of joining the St. Albans Cooperative Creamery, Inc. team in 1984 as the Controller. In 1991, I was provided the opportunity to take the position of General Manager/CEO of the Cooperative. I have the pleasure of serving in various capacities and committees serving both our state and northeast region of the dairy industry.

The St. Albans Cooperative Creamery, Inc. is a member governed dairy cooperative serving Vermont, New York and New Hampshire dairy farmers. Our membership comprises of approximately 500 members, producing in the range of 1.3 billion pounds of milk on an annualized basis. Our average member operation produces in the range of 2.4 million pounds of milk per year. Approximately 20% of our members produce 60% of the Cooperatives milk volume. When establishing and working on cooperative and dairy industry policies, it is important to represent all size farm operations.

Fifty-five percent of our milk volume is marketed directly to fluid and manufacturing plants throughout the Northeast. We operate a manufacturing facility in St. Albans, Vermont that separates approximately 45% of our milk volume to generate cream and skim solids for various customers such as Ben and Jerry's, Franklin Foods, Vermont Butter and Cheese, Saputo and other processors in New England and New York markets. Due to the Cooperatives shortage of skim solid markets, it is necessary to process excess skim solids into nonfat dry milk powder. We manufacture in the range of 10 to 20 million pounds of nonfat dry milk powder on an annualized basis.

Our team at the St. Albans Cooperative is comprised of 70 employees who are responsible for providing service, selecting stable markets and achieving the greatest return for our members by offering quality products and innovative service to customers. The Cooperative also is committed to providing active leadership for the dairy industry and in the political environment thereby benefiting all dairy farmers.

My testimony will reflect on the challenges that Vermont and other Northeast states are facing in agriculture, and the need to maintain dairy programs that provide support and economic stability for our agricultural industry.

2006 is proving to be an unprecedented year for dairy farmers. Our members are experiencing the lowest milk prices we've seen since 2003 (which mirrors pricing from the late 70's), escalating operating costs and adverse weather conditions.

Milk prices are currently at their lowest levels in over two years. There is uncertainty on the price outlook for the rest of 2006 and throughout 2007. Based on current price forecasts, we do not anticipate prices reaching levels to cover the cost of production during this timeframe. Below is a price forecast for the remainder of 2006 and 2007 that was prepared by the Vermont Dairy Task Force in June 2006.

Month	2006 Stat. Uniform	2007 Stat. Uniform
Jan	**$13.93**	$12.83
Feb	**$13.40**	$12.80
Mar	**$12.58**	$12.75
Apr	**$11.79**	$12.81
May	**$11.76**	$12.87
Jun	$11.72	$12.88
Jul	$12.17	$12.98
Aug	$12.50	$13.15
Sep	$12.74	$13.27
Oct	$12.93	$13.31
Nov	$12.91	$13.16
Dec	$12.84	$13.03
Average	$12.60	$12.99

**Statistical Uniform Prices are projected using 3.5% butterfat, 2.99% protein and 5.69% other solids.*
*** Prices that are shown in bold are already known for 2006.*
****St. Albans, Vermont County location.*

Over the course of the past three years, the St. Albans Cooperative has seen a significant decline in its average pay price to members. Listed below are the St. Albans Cooperative Creamery, Inc. average pay price "before premiums" from 2001 through 2006.

St. Albans Cooperative Average Pay Price "before premiums"

Based on Fiscal Year (Nov-Oct)

Year	$/cwt	Price per gallon
2001	14.92/cwt	$1.29 per gallon
2002	12.32/cwt	$1.06 per gallon
2003	11.94/cwt	$1.03 per gallon
2004	15.83/cwt	$1.37 per gallon
2005	15.29/cwt	$1.32 per gallon
2006 (thru April)	13.97/cwt	$1.20 per gallon
2006 (Projected)	12.40/cwt	$1.07 per gallon

In addition to depressed milk prices, farm operating costs have and continue to increase putting increased pressure on farm margins. This decrease in milk price combined with increasing operating costs will significantly impact the profitability of our member farms in 2006. The primary increase in operating costs is due to the increase in energy costs that have been absorbed by dairy farms over the past 2 years. Energy costs affect the fuel used to plant and harvest crops, electricity on farms, transportation costs and a variety of other essential resources needed to operate a dairy. Dr. David Kohl, Professor Emeritus Virginia Poly Tech states in the November 9, 2005 "Ag Lender" "On the cost side, nearly $8 of every $10 spent [on farms] is linked to the price of oil and energy through fertilizer, chemical, and other inputs."

The Northeast has been bombarded with significant amounts of rainfall through late spring and early summer. In St. Albans, Vermont, approximately 20 inches of rain has fallen between the months of May and June, which is nearly triple the average over the past ten years. These conditions have crippled farmers efforts in Vermont to plant corn and harvest hay. The Federal government has recognized this dire situation, approving a designation making all qualified farm operators eligible for low-interest emergency loans from the Farm Service Agency. The emergency designation with an allocation of funds from Congress will also allow the FSA to assist farmers through the Livestock Compensation Program, Livestock Assistance Program, Livestock Indemnity program, and Flood Compensation Program.

The impact of increased energy costs can also be felt in various areas at the Cooperatives facilities. St. Albans plant fuel costs increased from $694,135.65 in FY04 to $892,913.29 in FY05, representing a 28.64% increase. Fiscal year 2006 already shows signs of another significant increase over FY05. Lower dairy commodity prices, coupled with increased manufacturing costs have impacted the profitability of manufacturing operations. In turn, the lack of profitability impacts the dairy farmers who own and operate manufacturing and/or balancing facilities in the region.

The State of Vermont has seen the number of farms decrease over the past five years while the overall milk volume has remained level. In 2002, there were approximately 1,415 dairy farms in Vermont producing approximately 2.6 billion pounds of milk. Today, the number of dairy farms has decreased to 1,179 with production remaining steady at 2.6 billion pounds annually. Vermont has seen at least 46 dairy farms discontinue operations since the beginning of the year. Based on information from an economic impact study conducted by the University of New Hampshire, the Vermont dairy industry directly contributes approximately $1 billion into the Vermont economy. This figure includes producer payroll, producer purchases and processor revenues, excluding indirect revenues from the tourism industry. At the St. Albans Cooperative, producer payroll for its 500 members is down over $8 million when comparing January-April 2006 to January-April 2005, which are dollars that would have been re-invested into the states economy and that would have assisted in the viability of our farms operations.

The State of Vermont has taken action to combat the issues negatively impacting Vermont's dairy industry. Vermont's Governor, James Douglas, through the Agency of Agriculture formed the Vermont Dairy Task Force in the spring of 2005 to address the changing trends in the dairy industry in Vermont. The mission of the Dairy Task Force is to develop a set of strategies to improve the vitality, longevity and profitability of Vermont's dairy industry. The goals of the Dairy Task Force include: reduce costs, increase returns and increase profitability of Vermont dairy farmers as measured by a return on assets of 8%, increase the dairy herd to 150,000 animals, enhance the dairy industry in Vermont by attracting strategically important dairy processing to the state and to enhance the image and attitude of Vermont's dairy industry and dairy products for dairy farmers, the dairy industry, related agricultural businesses and the general public. In addition, Vermont's Secretary of Agriculture, Steve Kerr recently signed a Memorandum of Understanding with the Commissioner of Agriculture in New York and the Secretary of Agriculture in Pennsylvania to make the region's dairy farms more competitive and to give producers in the Northeast an opportunity to gain more market share through coordination of resources with the states working together as one. Farms in the three states produce approximately 25 billion pounds of milk per year, accounting for roughly 15% of the nation's total production. New York is the third-largest milk-producing state in the country, followed by Pennsylvania. Vermont is the 15th largest milk-producing state.

The initiatives that the State of Vermont has undertaken are critical to the long-term success of the dairy industry in Vermont. Unfortunately, these state programs combined with the MILCX program have not been enough to cover the operating costs on Vermont dairies. Hence, Vermont took on a third initiative to assist farmers financially on a short term basis. The State of Vermont instituted a Target Price Program in June 2006 to assist Vermont's dairy farmers in this time of great need due to the adverse weather conditions, high fuel prices and low milk prices. The Vermont Target Price Program is designed to provide payments in the near term to assist dairy farmers when the milk price is below $14.00 per hundredweight. The program will pay the difference between the target price and the combined announced Federal Order Statistical Uniform Price for the Middlebury, Vermont location plus the amount of the MILCX payment rate on a per hundredweight basis. This direct payment program has come at a critical time for Vermont dairy farmers, assisting in their efforts to remain viable businesses.

I would like to recognize the efforts of the US Senate Ag Committee for holding these hearings on the US Department of Agriculture's Dairy Programs. Dairy programs are vital components to our agriculture industry. It is essential to continually review and assess the need and effectiveness of those programs.

I am a proponent of the USDA establishing a policy that supports regional production of milk. Our agricultural and rural communities are an important part of the individual regions within our country's economy. The dairy industry alone generates approximately $1 billion to Vermont's economy.

I believe that from a bio-security and environmental standpoint that we would all benefit from ensuring that our dairy industry and food production is not highly concentrated in any one region in this country. It is essential that we maintain minimum levels of production in various regions of the country.

The 2002 Farm Bill included several programs that directly affect a dairy producer's income as well as conservation programs that provided assistance to dairy farmers in implementing various environmental initiatives.

Dairy farmers in the Northeast have many variables that can affect any given years production. A limited growing season can make farmers in the Northeast more vulnerable to adverse weather conditions than those farmers in other parts of the nation. Weather can adversely affect a farmer's crop yield, hence increasing the cost to feed a herd of dairy cows. The Northeast traditionally has had high operating costs compared to other regions and the Milk Income Loss contract program (MILC) has assisted tremendously in covering part of those costs in times of low milk prices. This safety net has enabled Vermont farms to remain viable during those periods of low milk prices. The MILC is similar to the Northeast Dairy Compact which provides counter-cyclical payments that are triggered when Class I milk prices in Boston fall below $16.94 per hundredweight. The MILC program provided a much needed safety net when farm milk prices hovered just below $12.00 per hundredweight in 2002 and 2003. Vermont dairy farmers received more than $45 million in MILC payments during that time.

I would like to thank the Committee's leadership and support for the extension of the MILC program. The MILCX program was extended until August 31, 2007 and payments in Vermont have already exceeded $2 million as milk prices began to drop dramatically in March of this year.

The one setback to the MILCX program is that it contains a 2.4 million pound production cap; discriminating between farmers of differing sizes. We need farms of all sizes to maintain a strong infrastructure, serving the needs of dairy farm operations within our region.

Approximately 30% of our members are affected by the production cap. In order to increase efficiencies in the utilization of labor, management and capital, many of these members have consolidated their operations, becoming multi-family farms. The size of the cap should be increased to take this into account.

The Federal Price Support Program has served the dairy industry very well over the last 6 decades and continues to be an important safety net for dairy farmers in the northeast. Although the federal support price is set relatively low at $9.90, it does provide a floor for manufactured products in times of the over-production of butter, powder and cheese. This program truly is a stand-by safety net program as it incurred almost no purchases or costs during fiscal year 2005 and throughout the first half of fiscal year 2006. However, in periods such as from July 2002 through June 2003 when prices received by dairy farmers were at 25-year lows, the program kept the industry from being in an all-out catastrophe throughout the country. The Federal Price Support Program is an important safety net program that benefits all dairy producers. The only suggestion that I would make is that the department should utilize its tilt authority with the utmost restraint when farm milk prices are on the upswing.

The Dairy Export Incentive Program is an important program that we need to encourage the Secretary of Agriculture to utilize to its maximum allowable levels. We need to market cheese, butter and nonfat dry milk to levels afforded under the current WTO agreements.

St. Albans Cooperative manufacturing of nonfat dry milk is not a profitable operation. The current Commodity Credit Corporation purchase prices for dairy products do not reflect the increased costs to provide product to the Commodity Credit Corporation. As a result market prices for individual products have, from time to time, been less than the support levels which on a milk equivalent basis provides for a price of milk at less than the statutory support level for milk of $9.90 per hundredweight at average test.

St. Albans Cooperative is participating in the self-help program; Cooperatives Working Together (CWT). Under this program, dairy farmers contribute 10 cents per hundredweight on all their milk produced in order to adjust the size of the nation's dairy-cow herd and more closely aligning milk supply to demand. In addition, the program assists in the exportation of dairy products, in an effort to market domestically producer dairy products internationally.

The CWT program has been effective, however is not intended to take the place of federal farm programs. Participation in the CWT program is voluntary and it will always have those who choose to take advantage of its benefits without contributing to the program. For this reason, federal farm programs are still needed as well as Congress's help in providing policy support to our industry.

As the Committee well knows, high energy costs have been particularly harmful to dairy farmer income. Dairy farmers require significant amounts of electricity to operate their facilities as well as diesel and gasoline for their equipment. In addition, dairy farmers have to pay the cost of transporting their milk. All of these higher energy costs have added anywhere them $1 to $1.50 per hundredweight to milk production costs. The 2007 Farm Bill's Energy Title needs to be significantly expanded to help develop alternative sources of energy. One important source of energy that has not been fully tapped has been the use of manure. Although methane digesters are being built on some dairy operations, this technology, along with other new and emerging technologies, needs to be developed so they are economically feasible for various size dairy farm operations.

The Federal Milk Marketing Order program assures dairy farmers a minimum price, assure that all competing milk buyers pay the same minimum price, assure that all dairy farmers share equitably in the returns of the marketplace and assure that the terms of trade are uniform throughout the Orders' marketing area. Although the federal orders serve as an important marketing structure that helps provide dairy producers with minimum prices for their milk, the order system itself needs to be streamlined so that it can respond quickly to changes that are needed when marketing conditions are altered due to external forces in the economy. The process for obtaining administrative changes in the operation of the federal orders is much too slow.

I would like to add a couple of additional comments on USDA's working lands conservation programs. Conservation programs on working agricultural lands bring environmental benefits to both producers and the public. Conservation thus represents a double value for the taxpayers by supporting sustainable agriculture and also enhancing the environment. The 2002 Farm Bill added significant authorization for expanded funding to the Environmental Quality Incentives Program (EQIP). In addition, the farm bill included an important Regional Equity requirement which has significantly increased federal working lands conservation funding for Vermont. When combined with State of Vermont programs, conservation programs have helped significantly to reduce run off around barns and other dairy facilities and has allowed for the increased use of filter strips and other buffers along waterways. Funding for EQIP and the Regional Equity requirement should be continued in the 2007 Farm Bill and expanded as well.

We need the Committee's strong support and leadership to clarify the Superfund law or its counterpart, the Community Right-to-Know Act regarding animal manure. Getting the law clarified this year should be a high priority as animal manure is not a toxic waste. Traditional farming practices should not be jeopardized due to unclear laws that impose strict, joint and retroactive CERCLA liability on dairy farmers.

In times of greater financial stress in agriculture, it is especially important to have effective loan programs to rely on. The Farm Service Agency is an important service provider to our member farms. The current FSA direct loan limit is $200,000 for both the operating loan program and farm ownership loan program. The limits need to be re-evaluated as the current levels no longer reflect the needs on farm operations today.

In Vermont and in many other states, additional loan funds are necessary to meet the current demand.

The FSA has worked to improve efficiencies within the agency. However, there are continued opportunities to streamlining the administration of this program. FSA needs to continue to incorporate more technology and web-based resources into their programs. In addition, FSA has two very different personnel systems that continue to separate the activities of the Farm Loan Programs from the Conservation and Commodity Programs that could be consolidated. Going forward, we may need to assess whether more resources are needed for these very efficient programs.

The average age of Vermont Dairy Farmers is increasing according to the 2002 Ag Census. The group of farmers over 60 years old own and control a large amount of farmland. We do expect that farms and land will continue to transfer to other generations or other farmers. With the age

DOCUMENTS SUBMITTED FOR THE RECORD

JULY 20, 2006

Testimony of Arden Tewksbury, Manager

Progressive Agriculture Organization,

RR 2 Box 165, Meshoppen, Pennsylvania

To the United States Senate Agriculture Committee

July 20, 2006

United States Senate Agriculture Committee
Washington, D.C.
Senator Saxby Chambliss, Chairman

My name is Arden Tewksbury. I live at RR 2, Meshoppen, Pennsylvania. I have farmed in Meshoppen Township all of my life. Currently, some of my animals have been moved to Faithopity Farms in Berwick (Columbia County), PA.

My testimony today is being made on behalf of Faithopity Farms and the 1200 members of the Progressive Agriculture Organization. In the past, I have been associated with the former Eastern Milk Producers Dairy Cooperative of Syracuse, New York, the Regional Cooperative Marketing Association from Syracuse, New York, and the Pennsylvania Farmers Union, Harrisburg, Pennsylvania. I have held various leadership rolls in all three organizations.

The Progressive Agriculture Organization (Pro Ag) was formed in 1991 in an attempt to give dairy farmers a stronger voice on dairy policy. Pro Ag works very closely with the National Family Farm Coalition located in Washington, D.C. It is Pro Ag's position that since 1981, the dairy policy that has been passed by the United States Congress and/or formulated by the United States Department of Agriculture (USDA) has failed our local dairy farmers miserably. For instance, the prices paid to Federal Order #1 producers was $12.61 per hundredweight (cwt.) from May 2006. In <u>1981</u> many of these dairy farmers were regulated by the former Federal Order #2 and were paid $12.83 per cwt for May's milk. However, in 1981, dairy farmers were paying $0.10-0.15 per cwt. to move their milk to the market. Today, many of these dairy farmers are paying up to $1.25 per cwt. to move their milk.

It is unthinkable that the United States Congress will allow the present pricing formula used by the USDA to determine prices paid to dairy farmers to continue. Since 1981, the U.S. Congress has passed various dairy programs which have ended up taking billions of dollars from the American dairy farmers. The reduction in the manufactured milk support price, the Gramm-Rudman-Hollings Deficit Reduction Act, the Milk Diversion Program, and the Whole Herd Termination Act are some of the culprits that have cost the dairy farmers the above mentioned billions of dollars.

Since the year 2000, dairy farmers have been regulated under what is called Order Reform. When Order Reform was implemented, I wrote an editorial which was titled "Order Reform, a Processor's Dream!" Order Reform is clearly responsible for the current idiotically low milk prices being paid to dairy farmers. While Order Reform did produce realistic prices for dairy farmers from April thru July during 2004, prices paid to dairy farmers have been far too low for dairy farmers to cover their costs of operation.

Many dairy farmers in other Federal Orders are experiencing the same problems as the dairy farmers in Federal Order #1. To compound even further potential problems for our dairy farmers, during the last part of January 2006, the USDA held a national hearing in Alexandria, Virginia, to consider increasing the "make allowance" in Federal Orders. If the USDA acts favorably on the proposal, then dairy farmers could end up having their prices decline another $0.45 per cwt. "Make allowance" is the term used to cover the cost of converting raw milk into manufactured dairy products. Since Order Reform took place in January of 2000, dairy farmers have seen their prices fluctuate from year to year as much as $7.00 per cwt. This can not continue. In addition prices paid to dairy farmers have declined an additional $1.60 per cwt. because a substantial amount of the "make allowance" is recovered by <u>processors</u> through a reduction in the Class prices that are used to determine prices paid to dairy farmers.

On January 25, 2006, three members of Pro Ag, Gerald Carlin of Meshoppen, PA, Donna Hall of Muncy, PA and Brenda Cochran of Westfield, PA, traveled to Alexandria, Virginia to attend the "Make Allowance" hearing. The four of us gave strong testimony against any further increases in the "make allowance" being charged to dairy farmers. The USDA has announced the hearing will reconvene during the latter part of 2006.

The "make allowance" fiasco is accelerating as U.S. Representative Gil Gutknecht, Chairman of a House Agriculture Sub-committee on dairy, has submitted a letter to US Secretary of Agriculture Mike Johanns urging him to issue an interim decision immediately. Of course, the decision Chairman Gutknecht is asking for is an increase in the "make allowance". This increase would further lower prices to dairy farmers. At the same time, six United State Senators, Russell Feingold (WI), Herb Kohl (WI), Jim Jeffords (VT), Hillary Clinton (NY), Charles Schumer (NY), and Arlen Specter (PA), have requested the General Accounting Office to make a thorough study of the Chicago Mercantile Exchange. This cash market plays an important role in establishing the value of cheese and butter.

New Dairy Policy Needed!

1. A new pricing formula must be developed which covers the dairy farmers' cost of production.
2. We urge the Senate Agriculture Committee to have representatives from the Economic Research Service (ERS), an agency within the USDA, to appear before your committee. This agency has survey records which indicate the cost of producing milk across the United States.
3. Urge the Secretary of Agriculture to immediately use Section 608 c (18) of the 1937 Agriculture Marketing Agreement Act. This section calls for the Secretary of Agriculture to use the dairy farmers' cost of producing milk in developing pay prices to dairy farmers.
4. We urge the Senate Agriculture Committee to initiate legislation which one more time would compel all Federal Milk Market Administrator Bulletins to carry the total economic cost of producing milk. These figures were available for a while, but they have now ceased. Some will say these figures are available on computers. However, there are many farmers, especially the Amish, without access to computers. These figures should be on the bulletins for everyone to see.
5. The Senate Ag Committee must be aware of the accelerated cost of producing milk. The staggering increase cost of fuel has placed an insurmountable burden on all farmers. These same accelerated fuel costs also flow over into all the ag services that are rendered on the dairy farms. All businesses are charging substantially more to dairy farmers for their services, but the dairy farmers have no avenue to recoup the tremendous increase in cost.
6. The Senate Agriculture Committee should obtain the real amounts of dairy products being imported into the United States. We ask the committee to evaluate the role these imports play in lowering milk prices to dairy farmers. Some reports indicate that the United States is a milk deficit producing country. In other words, the American consumer uses more milk then the American dairy farmers produce. If this is the case, than why can't the amounts of imports be brought under control to avoid adversely affecting dairy farmers' prices!

Short Term

Actions must be taken immediately to increase prices paid to all dairy farmers.

The American dairy farmers can no longer tolerate the disgraceful prices they are receiving.

Pro Ag strongly recommends the following:

1. Place a floor price under all milk prices of $14.50 per cwt.
2. Increase the Class I differentials in all Federal Milk Marketing Orders by at least $3.00 per cwt. If needed the $3.00 could be pooled nationally with all dairy farmers receiving a fair share. Presently, the Pennsylvania Milk Market Board (PMMB) has instituted a premium on Class I milk sold in Pennsylvania of $2.07 per cwt. This consists of a direct premium of $1.60 per cwt. and a fuel cost adjuster of $0.47 per cwt. The PMMB has had some form of premium on Class I milk for nearly 20 years.

The time is overdue for the United States Congress to take immediate action to correct the pricing inequities facing our dairy farmers.

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Guest Editorial by Arden Tewksbury, Manager Pro Ag

Will the Chicago Mercantile Exchange Be Investigated?

For many years, the Progressive Agriculture Organization (Pro Ag), National Family Farm Coalition (NFFC), and some others have been asking for various federal agencies to examine the Chicago Mercantile Exchange (CME) regarding the reliability of the CME to play a major role in the price discovery for milk prices paid to dairy farmers.

U.S. Senators Intercede

On July 13, 2006, six United States Senators submitted a letter to David Walker, Comptroller General of the Government Accountability Office (GAO), urging the agency to study the entire mechanism of the CME to determine if the exchange was a reputable source to determine dairy farmers' milk prices.

The six Senators are Senators Russell Feingold and Herb Kohl from Wisconsin, Senator Arlen Specter from Pennsylvania, Senator Jim Jeffords from Vermont, and Senators Hillary Clinton and Charles Schumer from New York. The Senators raise several questions about the CME. All of their questions basically center around the CME methods of operation.

Approximately 10 years ago, the Green Bay Cheese Exchange, in Wisconsin, closed under pressure from dairy farmers and some of the same six Senators including Senator Arlen Specter. The above mentioned people strongly criticized the methods being used by the Green Bay Cheese Exchange in determining the value of wholesale cheese. Each month, an agency of the United States Department of Agriculture (USDA) surveys approximately 110 cheese and butter wholesale markets to determine the value of wholesale cheese and butter. (These markets are all west of the Mississippi River.) The wholesale value of cheese is used to determine milk prices paid to dairy farmers.

California has become the largest milk producing state in the United States. However, California does not come under the jurisdiction of the federal milk marketing orders. The California dairy farmers are regulated under state orders within California. Several years ago, the California legislature passed laws that mandated California dairy farmers pay for the majority cost of converting raw milk into manufactured dairy products (these costs are called "make allowance").

The philosophy of dairy farmers' paying the "make allowance" has now infiltrated into the federal milk marketing orders.

Pro Ag helped to defeat an attempt to increase the "make allowance" charged to dairy farmers at a hearing this past January in Alexandria, Virginia. The proposal would have decreased milk prices paid to area dairy farmers by approximately $0.45 per hundredweight (cwt).

All farmers should appreciate the efforts of the six Senators as they attempt to do something about the low milk prices paid to area dairy farmers. These prices have now plummeted to the 1980 level.

Pro Ag can be reached at (570) 833-5776.

National Family Farm Coalition
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Testimony Submitted by Paul Rozwadowski,
Wisconsin dairy farmer, Chair of NFFC Dairy Subcommittee
Senate Agriculture Committee
Hearing to review USDA dairy programs
July 20, 2006

My name is Paul Rozwadowski. Along with my family, I milk 50 cows on a 360-acre family dairy farm in Chippewa County Wisconsin. I am pleased to submit this statement for consideration by the Senate Agriculture Committee on behalf of the Dairy Subcommittee of the National Family Farm Coalition.

As the summer season progresses, dairy farmers across the country are experiencing the worst combination of conditions in decades. Severe drought, persistent heavy rainfall, flooding, intense high heat and price below the cost of production are all raising havoc with the nation's dairy herd. The situation is resulting in poor quality feed, shortage of feed, abnormally low milk components (butterfat and protein), health problems (especially pneumonia, mastitis and heat stroke) and the inability to pay operating expenses. These conditions have already depressed milk production and will continue to do so through the fall (maybe longer) in a country with a dairy-producing deficit. We believe that imported dairy products are not the answer. Other dairy producing regions in the world are experiencing similar problems and there is growing concern among American consumers about the origins of their food.

The problems associated with achieving a price for raw milk that dairy farmers can function with are threefold:

- **Production expansion**
- **Imports**
- **Pricing system**

Problem #1 Expansion:

The problem here lies more with the decreasing number of smaller family farms than with expansion of milk production. Much of the dairy expansion in the West is currently due to a convenient little tax loophole. Tax Form 1031 enables a person selling their land to forgo paying any capital gains taxes if they reinvest in a like business. With land values in California in the $400,000 to $500,000 range per acre, these dairy farmers can sell out to developers, then relocate and build new cow factories 5,10, or 20 times their original size with the money they save on taxes. Small to medium sized family farms in other parts of the country that do not benefit from this speculation cannot compete with this loophole-created access to capital.

Milk production has doubled since 1975. However, it is not an overproduction. For the last ten years, milk production in the US has not kept pace with consumption in the US. (See Chart 1).

The NFFC believes that the low price of milk tends to increase expansion more than a high price for milk. Farm milk price that is below the cost of production forces a decision by the farmer to change one's farming practice (a switch to organics or grazing for example), sell out, or expand to achieve the multiplier effect. Family farmers are constantly told by processors, bankers, government, suppliers, and retailers, "If you want to make more money, you have to get bigger," or "Get bigger or get out." The truth is, getting bigger does not mean being more efficient. Smaller family farms are far more efficient in the long run than larger factory farms when factors such as culling percentage, death loss rates, breeding efficiencies, number of lactations and number of purchased replacements are weighed, as they must be.

Problem #2 Imports:

America imports dairy products from well over 100 countries, many of which have questionable sanitation. Most dairy imports drive the farm milk price down without any savings passed on to the public. Imports of milk protein concentrates should also be of great concern to Congress. MPCs are still untested and illegal by law to be used as a food ingredient in any capacity in the United States. Since when does a free market rule apply to illegal food ingredients with no safety tests? Virtually no other country in the world feeds this garbage to its people. The use of MPCs in cheese products creates poor quality and possibly unsafe products with short shelf life. These items are sold to unsuspecting consumers who think they are buying real dairy products. When this happens, we cheat the citizens of this country and insult American dairy farmers who strive to produce the highest quality milk in the world. (See Chart 2).

Problem #3 Pricing:

Congress, cooperatives, producers and private firms share the blame on this one, as massive consolidations of milk cooperatives and private enterprises have left the dairy industry's marketing and pricing strategies in the hands of a few individuals. Larger co-ops have vested interests with private firms causing collusion, corruption and manipulation of our pricing system, beginning at the Chicago Mercantile Exchange. Farmer members are so removed from the inner workings of the management of our co-ops that they do not have the means or the will to demand accountability of their co-ops' leaders. With market consolidation and antitrust violations gone way too far, competition has been nearly eliminated. Near-monopoly structures leave farmers in many parts of the country without an alternative place to sell their milk.

The price of milk that farmers receive and the cash trading for cheese at the CME has an almost perfect correlation. (See Chart 3). Daily trading of cheese at the CME happens most of the time with only two traders, one buyer and one seller, while butter trading lasts only a few minutes each day. Often there is no actual trade involved to change the price. All of this occurs with virtually no government oversight!

Farm milk price bears no relationship to U.S. milk production. Arguments about the market sorting out supply and demand are pure fiction. (See Chart 4).

It's not that federal policy can't have an effect on those structural changes that force out smaller farmers. It's not a given that the federal government has to stand by while agribusiness consolidates and consume larger and larger shares of the dairy market, by destroying competition. Under this administration, policy won't have a proper effect unless Congress demands enforcement of antitrust regulations that the USDA and the Department of Justice have failed to enforce. Without antitrust action we will continue to wonder why programs like MILC aren't working while ignoring the structural impacts of market consolidation.

In conclusion we ask this committee to keep in mind that the original intent of the farm bill is to protect farmers by providing them with a sustainable income. We are not greedy people; we only want to provide a living for our families and a chance to improve our farming practices so that we can pass our farms down to the next generation. The MILC payment program has helped to supplement the loss of family income but is insignificant in paying monthly operating bills. Agribusiness marketing and processing giants (as is the same for all large corporate entities) want to monopolize all the profits from every sector, wholesale and retail. Even government payments are merely passed through subsidies. Of course, the dairy farmer has absolutely no means by which he can provide an income other than taking whatever milk procurers decide to pay. The price support program at $9.90 is of little benefit to dairy farmers given the fact that the average cost of production (according to the USDA) for 100 lbs. of milk in 2004 was $19.83. Costs are significantly higher in 2006. Today we are receiving $11.15, which can keep no dairy farmer in business.

While I appreciate this opportunity to submit a prepared statement, I look forward to the opportunity to be present and testify at the upcoming dairy hearing that will be held to receive specific recommendations for policy changes in the 2007 farm bill. Dairy farmers need a fair price for their production. I look forward to presenting our proposal for changes in dairy policy; a program that will work for all family dairy farmers regardless of region and one that works for all of us in our role as farmers, consumers, and taxpayers.

Chart 1

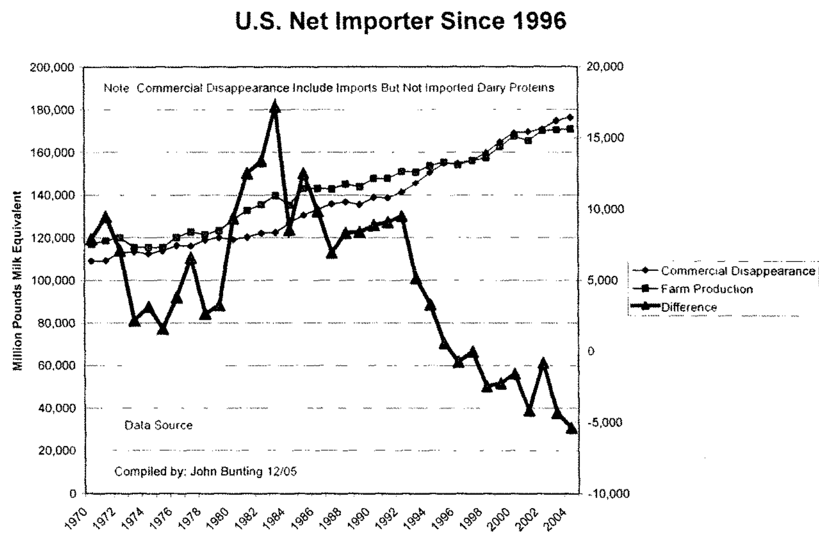

Chart 2

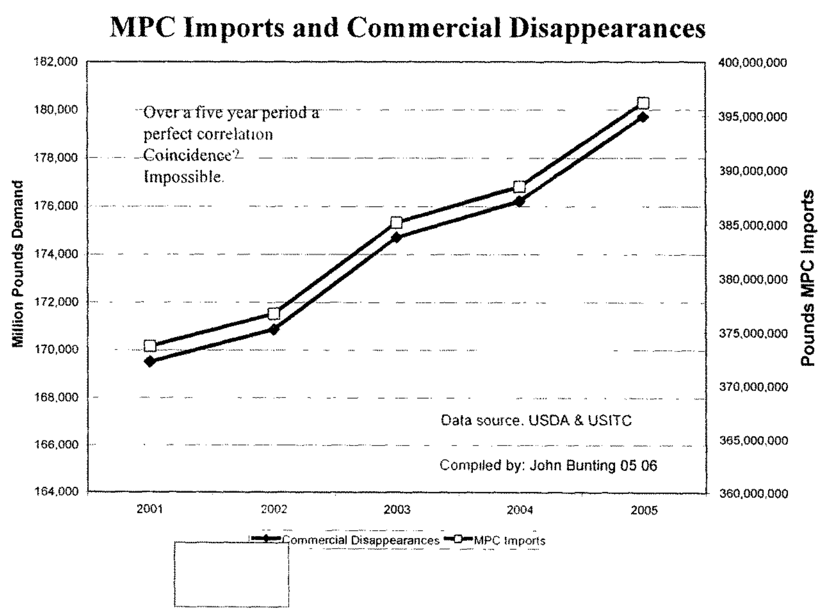

Chart 3

Correlation of CME/NCE Block Cheddar Price and Farm Milk Price

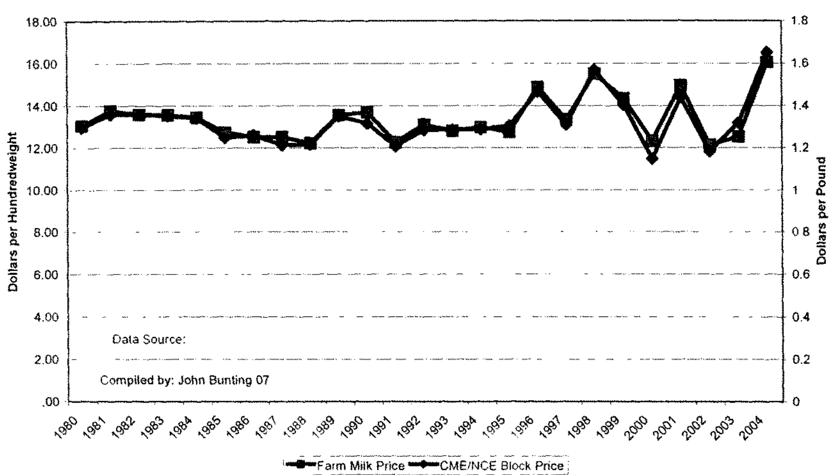

Chart 4

The Myth of the Market