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MILK PRICING: AREAS FOR IMPROVEMENT AND REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON
LIVESTOCK, DAIRY, POULTRY, LOCAL FOOD SYSTEMS, AND FOOD SAFETY AND SECURITY

OF THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
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C O N T E N T S

Wednesday, September 15, 2021

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MILK PRICING: AREAS FOR IMPROVEMENT AND REFORM

WEDNESDAY, SEPTEMBER 15, 2021

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:31 a.m., via Webex and in room 301 Russell Senate Office Building, Hon. Kirsten Gillibrand, Chairwoman of the Subcommittee, presiding.

Present: Senators Gillibrand, Leahy, Smith, Hyde-Smith, Ernst, Marshall, Grassley, Fischer, and Boozman.

Senator GILLIBRAND. I call this hearing of the Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security to order.

Thank you all for joining us this morning as the Subcommittee meets to receive testimony on the growing need to modernize the Federal Milk Marketing Order System to bring the Nation's dairy pricing into the 21st century market. Since this is the first Subcommittee hearing of the year, I want to start by welcoming Ranking Member Hyde-Smith, for her leadership and her work. I look forward to working together to provide our Nation's farmers with the tools, support, and resources they need.

To our witnesses, welcome. We have two panels today. Before I introduce the panels, I am going to introduce the dean of the Democrats to allow for his opening remarks because he has a conflict and he has to leave early.

Senator Leahy, if you would like to provide your opening remarks.

STATEMENT OF HON. PATRICK J. LEAHY, U.S. SENATOR FROM THE STATE OF VERMONT, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator LEAHY. Thank you very much, Madam Chair. I appreciate the courtesy of my neighbor from New York. This is an important and timely hearing. Only because of a conflict, actually, both Senator Durbin and I have, with Judiciary—I will not be here.

I think every Vermonter knows dairy never takes a day off, and so I particularly thank our witnesses for being here. I just talked with Ms. de Ronde, and I have welcomed her here today. She is speaking for Agri-Mark, which is an indispensable member of Vermont's dairy community. I would say to her, as I said before, I could always count on your predecessor, the late Bob Wellington, to provide sound counsel, and I know you are going to do the same.

Dairy is a bedrock industry in Vermont and the Northeast. It anchors our rural economies for generations. The years of price volatility, consolidation, rising costs have squeezed many small-sized farms. Vermont has been losing farms at a devastating rate, even before the pandemic. Since 2012, we have lost more than 40 percent of our dairies. That is 400 families no longer milking cows. That is impacting across our communities, our working landscape. Our farmers continue to struggle in an economic climate beyond their control.

Last month, I welcomed Secretary Vilsack to Vermont. Together, we announced $350 million in assistance to dairy farmers who received lower prices due to market abnormalities caused by the pandemic.

We have got to look forward to solutions and improve the resilience and increase transparency, address longstanding market inequities. I look forward to their perspectives.

Senator Gillibrand, I will put my whole statement in the record, but thank you for doing this. I know I do not have to tell you what dairy farms in the Northeast face. You have been a champion of them in your own State of New York. You have traveled to those farms. You have talked with the farmers. I think there is a lot we can work together on. Thank you very much.

[The prepared statement of Senator Leahy can be found on page 76 in the appendix.]

Senator GILLIBRAND. Thank you, Mr. Chairman.

I would also like to recognize the Ranking Member of the Ag Committee, Senator Boozman.

STATEMENT OF HON. JOHN BOOZMAN, U.S. SENATOR FROM THE STATE OF ARKANSAS, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator BOOZMAN. Thank you so much, Madam Chair, and thanks to Senator Leahy and to you, for your championship, nobody has worked any harder for the dairy industry than you all as the years have gone by, and it is certainly such an important industry.

I, too, would like to thank our witnesses for being here today, in person and virtually. The time you are spending away from your duties on the farm and from your work is not lost on us. We greatly appreciate your expertise and your willingness to guide us as we do our very best to serve you and American agriculture in general.

Over the August recess, I had the pleasure of visiting Helms Dairy in Arkadelphia, Arkansas. This fifth-generation farm, which has survived two world wars, major depressions in the farm economy, and steadily declining consumption of fluid milk and dairy products, is one of the remaining 40 dairies in Arkansas, which is truly amazing that we are at that point.

As Senator Hyde-Smith has shared, the number of dairy farms has steadily declined in many southern States. I am deeply concerned about this decline and look forward to examining this trend and ways to reverse it. While dairy policy may be a part of that conversation, the items I hear about most from dairy farmers and all farmers are concerns about higher taxes, higher input costs, and increasing regulation. Rising to each of those concerns is the tax-and-spend legislation that is getting ready to be forced through Congress.

In the last 40 years, the Senate Agriculture, Nutrition, and Forestry Committee has received budget reconciliation instructions 15 times. Between 1980 and this year, five committee chairs from both parties provided the leadership to ensure that there was some level of bipartisan input into the reconciliation process, whether that was a committee hearing, an open markup of the legislation, the bipartisan service of Agriculture Committee members on a conference committee, or legislation that was passed with the bipartisan votes of Senators from both parties.

Consideration of the agriculture provisions of the American Rescue Plan of 2021 was the first time in more than 40 years that this bipartisan committee tradition was not upheld. No hearings were held to listen to the needs of farmers and ranchers. No business meeting was held to afford committee Republicans and Democrats input into drafting the bill. Democrats did not convene a conference committee to consider any changes. The final bill passed Congress by a party-line vote.

I am deeply concerned that Democrats are choosing to go down this road once again. Without input from the agriculture community and without the input of Senators on this Committee, Democratic leaders in the House and Senate are preparing a $3.5 trillion tax-and-spend bill that better reflects White House priorities rather than those of the agriculture community.

Democrats have been saying for months that this legislation will spend billions of dollars on conservation programs, yet, earlier this week, the House Agriculture Committee approved an incomplete bill that included no conservation program spending as of yet. Apparently, $28 billion worth of conservation and other spending will be added later, perhaps on the House floor.

The bill did, however, identify something called the Civilian Climate Corps, which I think is better described as the Climate Police. We have no information on what the Climate Police may be, what its purpose is, how it will work, why it is needed, or any other answers to the most fundamental questions that American taxpayers expect this body to know and deliberate on before spending trillions of dollars.

We do know that President Biden's so-called "American Jobs Plan" proposes mobilizing the next generation of resilience workers to advance environmental justice. We also know that in this bill Democrats are directing the Climate Police to operate on Federal forest and private land. That is the last thing farmers and ranchers need.

The part that concerns me the most is the impact this partisan process will have on consideration of the next farm bill. Despite its high final vote tallies, passing the 2018 Farm Bill was no simple task. It took moderation on both sides and months of thoughtful deliberation to craft legislation that demonstrated wins for all. By choosing this approach, Democrats are shattering the farm bill process and putting our farmers' futures in jeopardy. Throughout this process, I and my Republican colleagues on this Committee will do everything in our power to defend American agriculture from the Democrats' reckless tax-and-spending agenda.

I yield back with that, Madam Chair. Thank you.

STATEMENT OF HON. KIRSTEN E. GILLIBRAND, U.S. SENATOR FROM THE STATE OF NEW YORK, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator GILLIBRAND. Thank you, Mr. Ranking Member.

I would now like to welcome our witnesses. Welcome. We have two panels today. The first panel includes Mr. Jim Davenport, Jr., owner of Tollgate Farm and member of Hudson Valley Fresh of Ancramdale, New York—welcome; Mrs. Christina Zuiderveen, a managing partner of Black Soil Dairy, LLC, of Granville, Iowa, and Mr. Mike Ferguson, owner of the Ferguson Dairy Farm, of Senatobia, Mississippi.

Our second panel, we will hear from Ms. Catherine H. de Ronde, Vice President of Economics and Legislative Affairs at Agri-Mark, Inc., in Andover, Massachusetts; Mr. Robert Wills, President of Cedar Grove Cheese, Inc. and Clock Shadow Creamery, LLC, of Plain, Wisconsin; and Christopher Wolf, E.V. Baker Professor of Agricultural Economics at the Charles H. Dyson School of Applied Economics and Management at Cornell University, of Ithaca, New York.

I look forward to hearing from you all and thank you all for sharing your time and expertise with us today.

Milk pricing is rightfully considered one of the most complicated economic systems in our Nation. When that system is not working for farmers, the ramifications reach from coast to coast, including in my home State of New York. New York is the fourth largest dairy producing State and the Nation's largest producer of yogurt and home to more than 3,000 dairy farms. When the milk pricing system leaves those farmers without adequate pay, the impacts are felt all across our economy.

Dairy farmers are facing rising costs of production, and current dairy prices are not covering them. Farmers' costs for needs like labor and fuel have been increasing for years, and the corn and soy used for feed are seeing a historic price rally. The consolidation and corporatization of the dairy industry has only exacerbated these issues. Large dairy operations have driven prices well below the cost of production, and family farms cannot compete with the economies of scale the mega producers have. Too many farmers across the country have been driven to bankruptcy and, in very tragic cases, in my own State of New York, suicide. Thousands of family farmers have been left with no choice but to leave the industry entirely. Between 2003 and 2020, there has been a 55 percent decrease in the number of dairy farms operating nationwide. We are in the midst of a modern-day dairy crisis.

Those struggles have only been magnified by the fundamental change made to the Class I pricing formula in the 2018 Farm Bill, which switched from using the higher-of Class III and Class IV to the average of the 2 plus 74 cents and an applicable differential. The 74-cent addition was based on the historic price difference between the two classes, but the historically calculated formula has failed to meet the needs of the present-day market.

Any time the price differential between Class III and Class IV is larger than $1.48, farmers are losing money. During the pandemic, government intervention left the price differential magnitudes larger than that. Class III prices skyrocketed while Class IV prices increased only slightly. Using the average of the two meant the pricing never fully captured the change in the market. It left Class I prices as much as $4.57 per hundredweight lower under the new formula than the old. That, in turn, led to $436 million in revenue lost to pools, record amount of milk being depooled, and record low producer price differentials. All told, by the summer of this year, the new formula had already cost dairy farmers more than $750 million in lost income.

I want to be clear. The pandemic and the economic downturn are not the only causes of this problem, but they did exacerbate it. The system cannot adapt to market conditions and, thus, is not fairly compensating our dairy farmers. The 2018 formula change is a symptom of the larger problems with our Federal Orders. The current Federal Milk Marketing Orders (FMMOs) system is confusing, convoluted, and too difficult to fully understand. Different Orders have different rules, and some parts of the country are not even under Orders.

The system is inadequate and out of date. We are using an almost 100-year-old system, which had its last major reform more than 20 years ago, for pricing for an industry where no dairy farmer is running their farm the way they would have 100 years ago. They should not be beholden to a price system that operates as if they are.

We must put the power back in the farmers' hands, help them recoup their losses, and build a system that ensures they get better prices moving forward so they are not put in this position again. To do that, it is going to take the combined efforts of farmers, processors, and cooperatives. Today, we will be hearing from all three on why the current system is in need of reform. I look forward to their testimony, and I look forward to working with you, Senator Hyde-Smith, to address these issues and much more.

With that, I want to recognize Senator Hyde-Smith for an opening comment.

STATEMENT OF HON. CINDY HYDE-SMITH, U.S. SENATOR FROM THE STATE OF MISSISSIPPI, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator HYDE-SMITH. Thank you, Senator Gillibrand, for holding this hearing today and to discuss milk pricing challenges. As a former commissioner of agriculture in my State, this is near and dear to me and has been a challenge for a very long time.

Thank you to our witnesses, our dairy farmers, and industry experts for taking time away from your very, very busy schedules to join us today because I know that is a hardship in itself, that you stop and take time to testify, but we certainly appreciate you doing this because it is so vital to hear from actual producers.

I am especially pleased to welcome Mr. Mike Ferguson of Senatobia, Mississippi. I know him well. He has been in the dairy business for over 40 years and runs an operation of approximately 150 head in North Mississippi. He has held a number of leadership positions in the dairy industry, has been very helpful, very vocal, and will bring valuable insight to the Subcommittee.

I thank you for being available today, Mike. You have always been so genuine and so concerned and active. You want to be part of a solution, and that is exactly the kind of people we need.

Before the pandemic, dairy producers faced multi-year period of low milk and dairy commodity prices. I am proud that during the 2020 years of COVID my colleagues and I advanced bipartisan legislation to support dairy farm families through the pandemic. Many dairy farm families are still in business today because of the Coronavirus Food Assistance Program despite the added price volatility and demand uncertainty caused by this unprecedented pandemic.

A key component of today's discussion will be the 2018 Farm Bill change to the Class I milk that has been referenced to already, the price formula, and a change that was included at the request of the dairy industry stakeholders. However, according to estimates by the American Farm Bureau Federation, this formula change resulted in millions of dollars of shortfalls. It has already been discussed. We know over $750 million to farmers supplying milk to beverage/milk processors.

The authors of that provision certainly could not have foreseen the severe market challenges that occurred in 2020 nor could they have anticipated the unintended economic consequences of that 2018 formula change. There are certainly options to address the situation facing dairy producers today, whether it is another statutory change to the formula or changes in the—achieved through administrative processes.

On another front, the decline in the number of dairy farmers in the Southeast is of particular importance to me and to Ranking Member Boozman. While Mississippi and Arkansas are indeed milk-deficit States, we consume more than we produce, and I am interested in examining whether aspects of the Federal Milk Marketing Order system make it more difficult for our producers to stay in business. The number of Mississippi dairy farms and farms across the Southeast has fallen dramatically over the last 40 years. I would like to help reverse that trend and be a part of seeing this come back. I am glad we are here today to discuss challenges facing the industry and potential opportunities to improve the Federal dairy policy.

While today's Subcommittee hearing is about dairy, I would like to also express my concerns about a more comprehensive topic which will certainly affect the dairy industry, the disastrous tax-and-spending packages that are being considered right now by our colleagues in the Democratic Party. As we speak, the U.S. House of Representatives is crafting legislation that aims to spend $135 billion or more just within USDA's jurisdiction on programs the Agriculture Committee oversees. The price tag of the overall bill is $3.5 trillion. This is deficit spending that will be paid for by hiking taxes on family farms. I expect this legislation will soon make its way to the Senate for consideration.

I raise these concerns because the Senate Agriculture Committee has not held a single hearing to consider any part of this bill and I do not anticipate that we will and this legislation will be able to pass with a simple majority, strictly party lines, harming the American farmer. Let me say that again: $135 billion in new spending on agriculture and climate programs financed on the back of hardworking family farmers, ranchers, and foresters across rural America. Unfortunately, the public has not had any input into this process. The same can be said about the most members of this Committee and Republicans as a whole. This is a product being developed by Democratic leadership behind closed doors, a reckless tax-and-spend agenda.

Farmers, ranchers, dairymen, consumers, and everyone in between have long benefited from the professional and bipartisan manner in which this Committee operates. This is not just a feel-good talking point. It is the way that we are expected to serve and the way that this Committee has operated for many years. I hope my colleagues keep in mind that as they contemplate going down a very concerning road for our country, our agricultural community, and for this Committee.

All that said, I am pleased that we are here today to discuss ways to help the dairy industry. Perhaps, we can even come up with some common-sense amendment ideas to improve the partisan package I just mentioned, which at this point, unfortunately, does not include any dairy-related provisions.

To our witnesses, again, thank you for your time, and I look forward to your discussion.

Thank you, Senator Gillibrand, for convening this very important hearing.

Senator GILLIBRAND. Thank you so much, Senator.

I would now like to recognize Senate Grassley because he has a conflict at 10, for your opening remarks and introduction of your witness.

STATEMENT OF HON. CHARLES GRASSLEY, U.S. SENATOR FROM THE STATE OF IOWA, U.S. COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator GRASSLEY. I have a privilege of introducing a witness. Before I do that, I want to put something in the record that associates my remarks with what the Ranking Member Boozman said about the irresponsible spending in the reconciliation bill and the tax policies that are going to be very detrimental to farming.

Welcome, Christina, Ms. Zuiderveen, Managing Partner of three dairies: Black Soil Dairy, Granville, Iowa; Mt. Hope Dairy, Beresford, South Dakota; Dakota Plains Dairy, Centerville, South Dakota.

On a day-to-day basis, Christina works in bookkeeping and HR. Christina is also on the Board of the Iowa State Dairy Association. She is also a member of Edge Dairy Farmers Cooperative, located in the upper Midwest, and serves on a regional milk pricing task force. She has previously served on the Central Plains Dairy Expo Board of Directors.

Christina attended Cornerstone University, received her degree in business marketing. She grew up on a dairy farm in California before her family took the operation to Michigan State. She now resides in Iowa with her husband, Nate, and their three children.

I last saw Christina in a discussion about all these issues we are talking about here today, when we had a small dairy farmers' meeting while the Iowa State Fair was going on in Des Moines. Welcome.

Ms. ZUIDERVEEN. Thank you.

Senator GRASSLEY. Thank you, Madam Chairman. Will you put this in the record?

[The prepared statement of Senator Grassley can be found on page 77 in the appendix.]

Senator GILLIBRAND. Thank you so much, Senator Grassley.

Then our last witness who has not been introduced is Mr. Jim Davenport. He is a dairy farmer from Ancramdale, New York. He has been a member of the Agri-Mark Dairy Cooperative since he and his wife, Karen, started shipping milk in 1986.

He is also one of nine farmer owners of the Hudson Valley Fresh. This group of farmers owns a bottling plant in Kingston, New York, and processes over one million pounds of raw milk each month into high-quality fluid milk, yogurt, sour cream, and ice cream mix. Hudson Valley Fresh supplies all the dairy products used by the United States Military Academy at West Point.

Thank you very much for being here today, Jim.

We just introduced Christina, and Senator Hyde-Smith introduced Mike. Mr. Davenport, you can proceed with your testimony.

STATEMENT OF LOWELL J. DAVENPORT, JR., OWNER, TOLLGATE FARM, MEMBER OF HUDSON VALLEY FRESH, ANCRAMDALE, NEW YORK

Mr. DAVENPORT. Okay. Thank you. Good morning. I would like to thank Senator Gillibrand for asking me down to testify today. On our small farm of 64 milking cows, I am over 50 percent of the hourly labor and over 90 percent of the management. Therefore, I am fully aware that there are 168 hours in a week. Any week that I work less than half of those hours is good. Taking time off to be here makes this a good week.

I would like—also like to thank Senator Gillibrand for her work on making the current Dairy Margin Coverage (DMC) program so responsive to the needs of the small dairy farms during this period of sky-high feed prices and inadequate milk prices.

When we started shipping milk in 1986, there were about 250,000 licensed dairies in the U.S. At the end of 2020, there were under 32,000. In 1986, the average dairy farm was 43 cows. Today, it is close to 300. In our Federal Order for a few years, we shipped about the daily average production for the Order. Lately, it has shot up to over twice what we produce each day, and our production has crept up because we are doing things more efficiently. Keeping small farms viable is critical for our survival.

As I stated in my written testimony, since its inception, the Federal Order system has served us well. Recent COVID-induced market turmoil, especially in the fluid milk business, showed the pricing system needs to be adjusted to reflect the current milk product mix in market swings. I know of no large independent dairy processors to be vertically integrated. Unlike the pork or poultry industry, dairy processors want nothing to do with milking cows. All of the vertical integration in the fluid milk business comes from the bottom-up. Dairy farmers are trying to capture a larger share of the consumer dollar.

People in the dairy industry are more knowledgeable than I are batting around ideas to reform milk pricing. The process the USDA uses to do this will work, just takes some time. We just have to be vigilant and keep a watch on what transpires and be sure it benefits the ones with the hardest job, the producers, the dairy farmers.

Forty years ago in ag economics class, I learned that demand for fluid milk is inelastic, meaning that consumers do not buy more when the price is low or less when the price is high. I hope that someone comes up with a plan to price fluid milk off of something less volatile than the cheese, butter, powder markets. If the consumer demand for fluid milk tends to be steady, then so should the fluid portion of the dairy farmers' price.

That is my written part of my oral. I see I have 2 minutes and 16 seconds left. I will just expound on that a little bit.

Basically, what we are hearing here today from the folks, Senators from in the southern part of the State, and any place there is a high fluid usage is it is tough to stay in business as a dairy farmer. The advantage they have in the heavily cheese-producing States is fluid is a very small portion of the milkshed, so it is very easy to serve the fluid processors.

COVID certainly proved in the Southeast United States a whole lot of milk got dumped; it did in the Northeast, too, but I think the Southeast wins the prize. It is just a matter of getting it so that the fluid milk price really reflects, you know, how much it—how hard it is to provide milk to the fluid processors.

We have—with our own brand, we are blessed to be two hours north of a whole bunch of people, eight million, nine million, Metro New York area, and who appreciate local, who appreciate, you know, knowing where their products come from. We have been able to capitalize that and do a consolidation in the dairy industry. We do school milk bids. We have actually put a price that can make our farmers a little bit better money than they would get from a regular processor and still have a low bid, and that is because of the consolidation in the dairy industry.

A lot of small plants have closed. In New York State, with all the milk that we make, in some of the areas where most of the milk is made, a lot of school systems can only get one bid. New York City currently is spending 17.5 cents a unit on fluid milk for their students' eight-ounce cartons. In the southern tier of New York, around Binghamton, some of those schools are paying 37 cents because they only get one bid. Whoever is bidding decides that, well, if there is only bid, I might as well make some money.

I think the fluid business has—that has to be addressed seriously in milk pricing, and I would really like to see them decouple the price for fluid milk from the international volatile cheese and butter, powder price.

Thank you for your time and thank you, Senators, for staying here and being here. I appreciate it. Appreciate your hard work. Thanks.

[The prepared statement of Mr. Davenport can be found on page 40 in the appendix.]

Senator GILLIBRAND. Thank you, Mr. Davenport.

Our next speaker is Mrs. Zuiderveen. You are recognized for five minutes.

STATEMENT OF CHRISTINA ZUIDERVEEN, MANAGING PARTNER, BLACK SOIL DAIRY LLC, GRANVILLE, IOWA

Ms. ZUIDERVEEN. Good morning, it is an honor to be here representing the many dairy families in Iowa and across the United States. Chairwoman Gillibrand and Ranking Member Hyde-Smith, thank you for giving me the privilege of taking part in our governing process.

I was born into a California dairy family who chased better market conditions into Michigan in the mid–90's. After we were married, my husband and I worked on his family's 500-cow dairy before taking an opportunity in an emerging dairy market, the Central Plains. I live with my husband and our three children in Northwest Iowa, but we also work closely with my brother in Southeast South Dakota. Together, across three locations, we milk 15,000 cows.

Most milk in the United States is regulated through FMMOs. This system was put in place decades ago to prevent dairy processors from making one dairy farmer bid against the other. In other words, FMMOs promise dairy producers that if their milk is as good as their neighbors they will be paid the same price. After decades of decline in sales of fluid milk, that promise now seems to be broken.

Although these conditions have benefited me personally in the last year, I am advocating for change because I want a fair system where everyone can compete on a level playing field. In 2020, cheese prices were very high. We ship to a cheese processor. Our milk check was high, and we were able to pay down debt and grow our operations. Meanwhile, some of our neighbors were forced to implement cost-cutting measures to stay afloat.

I have spoken to dairy farmers all across Iowa who are struggling because they are paid far less for their milk because they are not paid solely on that cheese price. Our prices are most definitely not uniform. This disparity is not unique to my region. I have family in California, Indiana, and Michigan with the same problem.

On the surface, it seems that pooling rules are the problem, but the deeper issue is that FMMOs do not provide market-based incentives to move milk to the processing plants where it is most valuable. For decades, FMMOs encouraged overproduction of cheap, nonfat, dry milk powder. When fluid sales were high, they subsidized milk powder returns. With fluid sales declining, per Federal Order rules, cheesemakers are left to subsidize powder through revenue pooling, and they declined to do so in 2020. Good intentions to create a system with uniform prices has resulted in a distorted system that is now coming unglued to the detriment of dairy families, whose income depends on the value of a blend of fluid milk, milk powder, and butter.

The Dairy Revenue Protection (DRP) and DMC have reduced the cost for producers to hedge against volatility and poor margins, but our pricing system must be improved to allow all producers to manage their commodity market risk. If dairy producers, like my neighbors in Iowa and my relatives in Michigan, cannot anticipate what class of milk will participate in the pool, they will not know whether their milk checks will be based on the cheese price or the butter and powder price, and they cannot hedge effectively.

This happened on my sister's dairy, where I was raised, in Michigan. Just like my dairy, they hedged based on the cheese price and incurred a loss. However, their milk check took a dive along with the Class IV markets, so their loss was compounded. Byzantine FMMO rules make it hard to predict how her farm's milk revenue will correlate with the main milk price benchmarks on the commodity exchange. The combination of unpredictable FMMO pooling and ad hoc government bailouts creates a moral hazard which further discourages risk management.

I appreciate that the DRP and traditional risk management tools are based on free markets. We should be sure to offer the same market-based freedoms to processors, who invest immense sums in our industry and also face commodity risks. We can modernize Federal Order regulations to provide consistent and predictable benefits and incentivize processors to react more quickly to shifts in market demand by redirecting milk to plants that produce the most valuable dairy products. The current Federal Order system is necessary and provides a safeguard against the market power of large milk buyers, but the system should be modernized to stimulate financial transparency and promote competition and innovation as opposed to consolidation among both processors and producers.

Promoting competition between processors will give dairy families a better milk price and incentivize the development of new products and markets. Competition is good for everyone. Every day, dairy producers must compete with one another for land, labor, livestock, and feed. The wide variance in mailbox prices caused by current pricing formulas creates a sense of helplessness among producers. While competition is good, it is unfortunate that Federal policies create an uneven playing field. When some producers receive as much as $9 less for their milk than their peers, even the best operator would not be able to compete in the long run.

As a child, my dreams for the future did not include owning and operating a dairy. Now that I have had the opportunity, I cannot imagine raising my kids in any other environment. They get to learn firsthand the value of hard work, where our food comes from, and how to care for the land and animals that God has asked us to steward. I am currently raising one equine enthusiast, one future vet, and one future dairyman. It is important to me that we design a system that gives them the best chance to accomplish their dreams.

Thank you again, Chairwoman Gillibrand, Ranking Member Hyde-Smith, and the rest of the Committee for your time. It has been an honor to be here.

[The prepared statement of Ms. Zuiderveen can be found on page 45 in the appendix.]

Senator GILLIBRAND. Thank you, Mrs. Zuiderveen. Appreciate you.

Mr. Ferguson, you are recognized for five minutes. I think he is here on Webex, yes. Go ahead.

STATEMENT OF MIKE FERGUSON, OWNER, FERGUSON DAIRY FARM, SENATOBIA, MISSISSIPPI

Mr. FERGUSON. Chair Gillibrand, Ranking Member Hyde-Smith, and members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Mike Ferguson, and I have operated a Holstein milking herd of 150 head in Eastern Tate County, Mississippi, for 45 years.

The dairy industry in Mississippi currently consists of about 60 family farms. We are considered a milk-deficit State, where we do not produce as much milk as our State consumes, so milk must come in from other States. Mississippi is steadily and rapidly losing dairy farms. Over the past five years of extremely low milk prices, producers have struggled to put food on their families' tables while providing it for the rest of us. We have lost approximately 26 dairies over this time, from 86 in 2016 to 60 at the present time, a 30 percent decrease. Many of our 60 family farms in the State will not be here in a few years if things do not change.

I would like to focus my brief testimony today on areas of improvement that Congress could review to make an impact, to reverse this trend of the loss of dairy farms in the Southeast. Congress subsequently modified how Class I milk prices were calculated in the last farm bill to dairy farmers at the request of the industry. Under these new provisions, Class I milk is calculated based off the average of advance Class III and Class IV prices plus an adjusting factor, which defines the Class I mover. Previously, Class I price was based upon the higher of Class III or Class IV, considered the higher-of method.

During the initial onset of the COVID–19 pandemic, the traditional pricing mechanisms of Class I were skewed tremendously due to the unprecedented purchases of cheese by the Federal Government that set Class III prices significantly higher than Class I and created a vast disparity in the true value of Class I milk. While dairy farmers were, no doubt, grateful for the needed relief through the purchase of cheese products during the pandemic, the way it was done had significant unintended consequences that no one could have seen coming. While dairy farmers are eager to do everything possible to help people consumer our products, it should have been done in a balanced way to minimize price disruptions.

I would like to mention a few recommendations to alleviate this issue for the future. Congress should consider immediately going back to the higher-of until the dairy industry can proceed to a national rulemaking process through USDA's dairy programs to consider alternative Class I milk pricing rules. A more frequent and thorough review of the national adjusting factor in the Class I mover calculation could be considered by either the transparent rulemaking process or congressional action.

Another potential solution to alleviate the decline of the dairy industry in the Southeast is consideration of multiple component pricing. In light of the recent economic realities of the dairy industry, there has been a renewed interest in the Southeast U.S. to consider abandoning the existing pricing system, skim fat, in favor of adopting multiple component pricing. In the Southeast region's Federal Orders 5, 6, and 7, milk is not priced based on all the components of milk. Rather, milk is priced on skim and fat alone, ignoring the value-added of protein in the milk.

In the Southeast, the rising value of milk proteins, combined with the region's alternative milk pricing scheme, is believed to have contributed to the challenges related to milk procurement. It is likely that milk proteins will continue to be a major nutritional and an economic value-added dairy product in both domestic and international markets. Implementing a more uniform pricing scheme across large portions of the U.S. will help to improve component productivity and drive milk to its highest value and best use.

Multiple component pricing is a very equitable idea. It is based on the concept that the regulated price of milk received at the farm level should reflect the functional and economic value of the milk. Importantly, for farms like mine in the Southeast, component pricing could improve the price for the milk we receive, and it could facilitate innovation and investment in the Southeast dairy industry. This, too, can be addressed through a rulemaking process, but I urge the Subcommittee to carefully consider this issue in our conversations.

In closing, thank you for the opportunity to testify before you today, and I look forward to working with you to reform milk pricing for the betterment of all producers and stand ready to answer any questions that you have. Thank you.

[The prepared statement of Mr. Ferguson can be found on page 48 in the appendix.]

Senator GILLIBRAND. Thank you to our witnesses for your introductions and your statements.

I would like to ask the first panel some questions about the challenges facing smaller dairies. As I noted in my opening remarks, the loss of dairy farms this century has been staggering, with many of them being small dairies. Can you please share some of the challenges that small farmers face in the Federal Order system that larger and mega dairies do not have to overcome?

Mr. DAVENPORT. I guess basically, in our Federal Order 1, the smaller dairies, well, they are at an advantage—a disadvantage. A lot of them have—just do not have the ability to expand due to geographic concerns. I feel that the Order system—we get paid fairly through the Order system. I do not know that the Order system is responsible for us getting a lower price than, you know, our neighbors that make much more milk.

I will say as far as the fluid part of the business I think that if we could have a better fluid portion of our milk price it would be, you know, very helpful. A lot of small farms, they end up serving the fluid market in Federal Order 1, and I think it would be beneficial to get a better price.

I just think it is unfortunate, but I think the last secretary of agriculture said something that raised the hackles of small farmers. He said something to the effect of: In the dairy business, get big or get out. Those of us that choose to stay small and nimble and do some value-added stuff are going to try to keep in business by doing that. Just do not want to expand, and you just try to do a much better job with as few—I figure if you can milk as few cows as possible once a day that would be ideal. Just try to be very efficient.

I do not really know. Other than fluid milk price discovery, I cannot think of anything the Order could do to benefit the small farmers. A lot of the programs we have had—the DMC is awesome. That has worked really, really well on our farm. We feed a high-forage diet, so totally takes care of our issues with high grain prices.

I just—off the top of my head, and hopefully economists have some better ideas, I really cannot think of anything that the Order could do to benefit small farmers. I think it can do things to benefit all dairy farmers and the price of milk, but I honestly cannot come up with anything that would be reasonable.

Senator GILLIBRAND. Do the other two witnesses want to add or contribute to that question?

[No audible response.]

Senator GILLIBRAND. Okay, Class I mover modifications. As has been noted in the hearing today, because of the unforeseen circumstances due to the pandemic and subsequent economic downturn, the 2018 Farm Bill change to the Class I mover resulted in hundreds of millions of dollars in lost income for dairy farmers. There have been various proposals from industry stakeholders suggesting modifications such as temporarily returning back to the higher-of formula until a new proposal that garners consensus can be reached. What changes to the Class I mover would you all suggest?

Mr. FERGUSON. Senator, I think that the Class I mover—there are a couple of things that could be done in my estimation. One is that if we go back to the higher-of a thorough investigation, or not investigation, but a thorough study of it could be done to find out the true effects of where we are and the improvement in the adjuster portion of that, a more timely review of it. As now, I do not believe there is any review of that. If we could look at it on a yearly basis or something of that nature, that would be very beneficial for us, but the DMC is a huge, huge plus for us. I just want to echo that while I have that moment.

Senator GILLIBRAND. Thank you.

Mrs. Zuiderveen?

Ms. ZUIDERVEEN. Yes. I would just like to say that I am opposed to a temporary solution. I think that we need to have a committee study this fairly in depth so that we can solve this long-term and not have to address it multiple times in the next few years.

Senator GILLIBRAND. Agreed. Mr. Davenport?

Mr. DAVENPORT. Yes, I—currently, right now, I think the current pricing system we might be making—doing a little better than the higher-of than we had before at this current time. The only thing I would say is I do not feel that we are out of the woods yet on the COVID thing and supply chain disruptions, and I personally—as a stop-gap measure, I would have no problem going back to the higher-of for now. It may upset the processors a little bit, but I hope they made a lot of money when our price was not so good, that they could have a little cushion to fall back on.

I do certainly believe that we do need to not get rid of the Order system but get it straightened out so that every farmer can get a fair price for their milk and it gets to the highest and best use, the way that Order was intended.

Senator GILLIBRAND. Thank you.

Senator Hyde-Smith.

Senator HYDE-SMITH. Thank you, Senator Gillibrand.

Mr. Ferguson, another recommendation you provided was a more frequent and thorough review of the national adjusting factor in the Class I calculation. What role does the adjusting factor play in this process? Could this change, more frequent and thorough reviews of the adjusting factor, be done administratively through the rulemaking process? Then would that be more ideal rather than waiting on the next farm bill?

Mr. FERGUSON. Senator Hyde-Smith, that would be a "yes" to that. The rulemaking process is where that should occur, and it would be advantageous because even through the rulemaking process, sometimes that moves along as slow as molasses. As far as the next farm bill, if we have another year like we had in 2020, there will not be that many dairy farmers, especially I think in the Southeast, that are going to be in business to have the opportunity to take advantage of any changes that would be made to have us to be above water as opposed to underwater in our operations. In my particular case, it was catastrophic. We had a 30 percent loss from month to month on how the mover moved in unprecedented ways. Yes, it would; the rulemaking process is the route for this.

Senator HYDE-SMITH. In your testimony, you also provided some recommendations to what would help alleviate these problems, such as going back to the pre-2018 Farm Bill higher-of price method. Are you looking more at going back to that as a temporary, or what are your thoughts on—or your additional details that you can give us on—the long-term solution instead of going back immediately to the higher-of?

Mr. FERGUSON. I think we need to use that as a temporary solution because what we heard on the first, when it came out of the farm bill, was that there was not really enough time to have an extended study that would come up with the correct amount of the adjuster and things of that nature, that—where that adjuster actually helps that Class I price find its true value. If we have things in place, a study that shows exactly what that adjuster should be, how often it should be before we review it, that would be very beneficial.

Senator HYDE-SMITH. Thank you.

Senator GILLIBRAND. Senator Boozman, would you like to ask some questions?

Senator BOOZMAN. Thank you, Madam Chair.

Again, thank you all for being here. This has been just a great hearing with a lot of thoughtful testimony and also some answers as to how we move forward.

According to my colleagues, the justification for the reckless tax-and-spending legislation that we are about to address, is the climate infrastructure needs of the United States. Dairy, livestock, and poultry production accounts for nearly half of all agriculture cash receipts at approximately $191 billion annually. Yet, at this point, this legislation provides no funding for the animal agriculture sector for research, climate mitigation, or any other priority. Yet, you are going to be on the hook for paying the taxes for it.

There is millions in the bill for urban agriculture, billions for tree equity, whatever that is, but there is not a dime directed to assist the dairy industry. The bill does, however, include $2.9 trillion in additional taxes.

As farm groups have continuously shared, if proposed changes to stepped-up basis are included, which is still a possibility later in this process, it will be devastating to family farms. Texas A&M came out with a study, and according to the representative farms studied by them, dairy farmers would be among the hardest hit.

In addition, the bill contains changes to estate tax provisions that would force many farmers urgently to modify their estate plans just to ensure the future of their family farm.

Mr. Ferguson, how would the proposed changes in stepped-up basis impact your family business?

Then the other thing that is included in this is the Green New Deal, which would significantly increase your electricity, your energy costs, your oil, gas–the things that you rely on an everyday basis. How would that affect your bottom line?

Mr. FERGUSON. Senator, anytime you have increase in expenses you have got to look at ways to cut in other areas. Well, I am telling you the small dairy farmers in the Southeast, we do not have those resources where we can cut in those other areas. We cannot afford this additional tax burden. These farms that have been in the family for generations, they will be going by the wayside. Our security net of a safe and effective food source for our consuming public would be out the window.

I think it is in someone else's statement earlier; there was talk about fresh and local, basically. You would have these pockets where all your food would be produced, and some of the things that would be produced would have a hard time getting to market. We have a huge problem with trucking as it is now.

I just see no way that we can add anymore tax burden to the farm as it is, as a unit now. The thing is we have worked all of our lives to establish these farms, and in a lot of cases you have got other family members waiting in line.

On the stepped-up basis, there are farms that have gone up three, four-hundred percent in value. How can we possibly tax these farms at that rate, adding this extra burden to the local farmers? I just—I cannot see the logic in that.

Senator BOOZMAN. Would anybody else—would you all like to share in that also, very briefly, or the Chairwoman is going to gavel me down.

Ms. ZUIDERVEEN. I would like to share that my family—I am one of five siblings, and we are currently going through some transitioning with those siblings. Talking about what the future looks like without stepped-up basis is detrimental to our operations. Through this process, my husband and I are also doing our own estate planning, and it is very scary to look at what that will look like for my children and how they would keep our dairy together if the stepped-up basis was taken away.

Mr. DAVENPORT. My opinion on that whole matter is if a family has been in farming for generations and have built something up—

and a lot of times the value of what they have is influenced by local real estate, which may not be, you know, farming—I strongly feel that if the farm stays in farming they should not be burdened with any extra estate taxes.

Now if, which I have seen in my neck of the woods way too often, a family farm goes out and one sibling wants to stay going, the other four see dollar signs and they cash in, at that point I feel that they should pay the estate tax because it is not producing food anymore. You know? As far as if it is going to stay a farm, then I think there is no reason that they should be—have extra burden of transition taxes to the next generation.

Senator BOOZMAN. Thank you, Madam Chair.

Senator GILLIBRAND. Thank you very much, Senator Boozman.

We have Senator Smith by Webex.

Senator SMITH. Good morning, Madam Chair, and good morning, Ranking Member and to all of our panelists. It is great to be with you virtually.

Madam Chair, if I may, I would like to just issue—just to clarify something following on the Ranking Member's questions about stepped-up basis. I just want to make it clear that the budget resolution that the Democrats have passed, and in fact the work that we are doing right now on the Build Back Better Budget, specifically excludes any changes to the stepped-up basis. There has been a lot of talk about this. I have had many conversations about this with farmers, family farmers in Minnesota. I just wanted to be clear about that issue.

To the topic at hand, what is going on with dairy farmers across the country, I want to start out by talking about Minnesota a little bit. Dairy farmers in Minnesota tell me that they are squeezed in the marketplace. They would hear the stories that you all are telling today and say that they sound familiar to them. They find that milk prices are consistently below the cost of production for them, and slim to negative margins forced many dairy farmers to use up their equity and their savings to keep from going out of business over these last few years. I think we all know that there are 40,000 fewer licensed dairy herds in this country than there were in 2002.

You all, I think, make the case for the lack of transparency and the problems with lack of farmer input into the milk pricing system, which has played such a significant role for dairy farmers. The reality is that the milk—Federal Milk Marketing Order is 80 years old. It is an 80-year-old system, and so it is not easy to understand. One statement I read really sums this up. It said, so many variables are involved that the typical farmer knows what their milk check will be worth, but only an economist can explain it.

It also—the Federal Milk Marketing Orders are regionally based. I know that there are discussions around evaluating the individual sections of this system. Dairy farmers in Minnesota and in the Midwest have said that they need to take an approach that evaluates the entire system and that any other way would be really counterproductive.

What I would like to do is hear from the witnesses about this question first. How can we modernize the milk pricing system in a way that takes into account the differences amongst dairy producing regions and ensures that our system matches the realities facing dairy farmers and their cooperatives that process and market the milk that they produce across regions? I would be happy to hear from any of you or all of you. Maybe, Mr. Davenport, would you like to start?

Mr. DAVENPORT. Sure. Thank you for attending virtually. Yes, I think basically we have seen the prices of the commodities—cheese, butter, and powder—reflect the world market, and there is also a futures markets. I think that they have become less reliable.

As I have said before, I think because fluid demand is sort of steady we ought to have a steadier price on the fluid and find a different way to price fluid milk. I think it would be especially beneficial to the higher fluid Orders that do not have a lot of options to send their milk—the farmers have no options a lot of times to send their milk to another processor and get a fair price, trucking, a lot of times being the limiting, you know, factor in that.

I do feel that the Order system can be corrected, and we just have to get some ideas and make sure that they are good with the farmers and everybody involved in the business.

Senator SMITH. Thank you.

Would the other panelists like to comment? I would love to hear your perspective on how we can account for regional differences as we think about reforms.

Mr. FERGUSON. Senator, thank you. This is Mike Ferguson. We in the Southeast, we are in a different area than any other part of the country. We are in such a—it is such a tremendous milk-deficit area, where we—for the whole Southeast, we only provide like 45 percent of the fluid that is consumed in the Southeast. It is only going to exasperate because our farmers are leaving, yet our consumers are growing by leaps and bounds if you look at the numbers where the population is growing, and one of the biggest problems we have, most of the milk in the Southeast is co-op-based.

I mean, the farmers are members of co-ops. It is on the back of the co-ops to bring in this supplemental milk or the milk to fill the needs in the market. The cost of transporting that milk in is on the backs of the dairy farmers because there is no mechanism where we can recoup that cost of bringing that milk in, to provide milk for the consumers. If we have something and I am sure you are familiar with something like milk allowance for transportation or balancing the market—that would be very beneficial to our part of the world and would be of great help.

Senator SMITH. Thank you very much.

Madam Chair, I realize I am out of time. I want to just thank you for holding this hearing, and I am grateful to be a part of it and some good food for thought as we think about where we go from here. Thank you very much.

Senator GILLIBRAND. Thank you, Senator Smith.

Our next Senator is Senator Ernst.

Senator ERNST. Thank you, Madam Chair. Thanks to all of our witnesses for being here today, and a special thank you and welcome as well to Christina Zuiderveen, and it is great to have you here and representing our home State of Iowa and our dairy farmers.

I would like to ask all of you, but, Christina specifically, I will start with you. The pandemic was really difficult on so many of us, and I remember many of those days sitting in Red Oak, Iowa, on Zoom calls or Skype calls with commodity groups and just hearing the stories evolving and growing out of the pandemic and the challenges that all of our farmers and ranchers, dairy producers were going through.

If you could maybe explain to us a little bit about some of the issues, experiences you had. You talked a little bit about the Federal Milk Marketing Orders. From the Iowa dairy perspective, can you talk about some of the other issues that came out of the pandemic and what should be the greatest takeaway that we have?

Ms. ZUIDERVEEN. One of the biggest issues that was sort of exasperated by the pandemic was the ability to hedge. Like I said, we ship to a cheese plant. We know that 100 percent of our check is going to be based on that cheese price. When you ship to a different processor that has some fluid milk or softs, different classes of production, their milk check will be based on a blended number. So they are—they cannot effectively guess from month to month what that percentage is going to be and where that number is going to come from, and they are effectively out of the option of hedging and protecting themselves from losses that come in with market volatility. Then obviously, if anyone could have predicted the pandemic, we could have predicted our milk price, but that is not going to happen. So we need the ability to better predict our milk price so that we can protect ourselves with the programs that are offered.

Senator ERNST. Yes, thank you. I did note through some of my discussions last year as well that because we had school closures and the school lunch milk program they were not using those same cartons anymore. Then it became an issue of how do you ship milk maybe in a different form, rather than to the schools then to our marketplaces. Any thoughts on that as well?

Ms. ZUIDERVEEN. Absolutely. That is a production line issue, which I think we saw in every industry. You cannot just take the equipment that is producing those cartons and make it a sour cream container. It does not work. That takes building a new plant, building a new line, having the employees to do that. I think that is one of the biggest things we look at.

One of our fears right now is that there is not enough truckers. What happens when we cannot haul our milk, a perishable product, to the facility that can take it? What happens when that facility does not have the staffing to take it? This is not something we can just put in the freezer and use next week.

Senator ERNST. Absolutely. Any other thoughts from our witnesses?

Mr. DAVENPORT. I agree with Christina. Definitely, that was a problem. Just the food chain really got upset a lot. I know that it was great; our own little group, we did an awful lot of food pantry. One of the good things the former Governor of New York did was have the Nourish New York Program, and we were paid, you know, a fair price, the price of us processing the milk into gallons and sent it to food pantries. It was all—no waste happened there. Every bit of it went to people that needed it.

I—you know, I truly feel that the supply chain needs to be more robust. We all know, at least in our neck of the woods, there are “help wanted” signs everywhere. I do not know what is keeping people from working, but our Cabot plants in Vermont—during the pandemic we had sales staff, you know, working double shifts, running the plant. We had demand for more cheese, and God knows we had plenty of milk to make the cheese, but we had to shut down production on the weekend because there was nobody willing to work. It is foreign to me. As I said, I tend to work some pretty long hours and much to the chagrin of my family, but I am still in business. It is a problem, and we have to address it.

I think one thing that has not been said yet, but I do believe whole milk in schools would definitely be a big boon. All milk tastes better—no matter who processes it, their whole-fat milk always taste better than the low-fat milk.

In the consolidation industry, a lot of small dairies that really care about quality—it is a whole other story, but they have not—they have been replaced. They sold out to a large dairy. Plants were closed. Like I said, some schools in our State are paying over twice what they pay in New York City for milk, and they are right by the producers.

Senator ERNST. Wow.

Mr. DAVENPORT. That is something that needs to be addressed. Kids should be drinking milk. This is a true plant-based beverage. I mean, that is all our cows—80 percent of our diet sometimes is plants for our cows, and they are the natural factor that makes the awesome stuff.

Senator ERNST. Outstanding.

Mr. DAVENPORT. In your neck of the woods, our neck of the woods, we do not do any irrigation. It is all what Mother Nature provides.

Senator ERNST. Yes. Right. Well, I appreciate that. I apologize, my time is expired. I do appreciate the input and not only as we look at pricing and how we can modernize the pricing system but then also those supply chain management issues that so many faced over the pandemic.

Thank you, Madam Chair.

Senator GILLIBRAND. Thank you, Senator Ernst.

I agree with you, Mr. Davenport. I think whole milk in schools would be wise. I know my children only will drink whole milk. It is better, more delicious, and very healthy. Children will feel fuller, so they will eat less junk food. I am in favor of that recommendation.

Our next Senator is Senator Marshall.

Senator MARSHALL. Well, thank you, Madam Chair and Ranking Member, for doing this. Guess what? I agree with you. I just want to be on record today that I think that milk is the most delicious, most nutritious drink known to mankind, that mankind has never made a drink that could supplant it, and whether you are trying to develop an immune system to fight RSV or the common flu or COVID–19, that milk is a very important part of that nutritious diet, and whole milk especially because it helps us absorb fat-soluble vitamins A, D, E, and K.

That is so important, as an obstetrician, a gynecologist, that we have that whole milk and to grow strong bones as well, that we now have a generation of men and women who are going to have osteopenia and osteoporosis 10 to 15 years younger than their predecessors because of a Federal nutrition policy that basically disallowed whole milk.

Whole milk is what gives us the flavor, the taste. That is why kids drink it; because it tastes good. I do not like one percent milk. I get so mad at my wife when she does not bring me some whole milk home. I try to drink it for lunch every day here, two cartons of whole milk. We got it back on the diet for the Senators. I want you to know that.

I am excited to talk about dairy because it is personal. My dad, his family, had a 30-head Holstein dairy farm 30 years. Like Senator Leahy said, did not miss a day of work. Right? You do not miss a day of cow. The cows have to be milked twice, now three times, a day.

I am excited to be on this Subcommittee, helping out our dairy farmers. I think they have probably been more negatively impacted than any other ag sector that I can think of over the past four, five years. It just feels like the seven plagues of Egypt have hit the dairy industry.

Madam Chair, I am excited to learn that you are the largest producer of yogurt; New York is. I did not know that, so that is great to learn.

Kansas has the fastest growing dairy herd in the Nation as well, and we are very proud of that. Additionally, Arizona, California, Colorado, New Mexico, Oregon, South Dakota, Texas, Washington State, and my home of Kansas are responsible for about 40 percent of milk production, and all operate in Federal Milk Marketing Orders.

The year 2020 exposed some very significant vulnerabilities in the way we price milk in the Federal Milk Marketing Order systems. Neighboring dairies producing the same quantity and quality often receive different prices based on who they were selling their milk to. The difference was not based on sound economic principles but was based on the impact of the Federal Government opting to mandate the purchase of millions of pounds of cheese, providing a milk price windfall to any dairy farmer supplying cheese manufacturing.

I am all in favor of cheese. I love cheese. It is very nutritious and so glad we could get more cheese out to folks who needed the nutrition help. There is no such price relief for those neighboring dairies who supply local bottling plants or the butter manufacturers.

Then the USDA announced last month they would provide some mitigation for that 2020 inequity. They put a cap on the relief that ensures my dairies in Kansas and throughout the U.S. only a tiny fraction of aid on a representative basis. Our policy should not pick winners and losers based on the farm size or geography.

As I look out and consider the challenges in the dairy industry right now, my biggest concerns are the taxman and rules and regulations. I think that several of us have talked about stepped-up basis, that that would be the end of the family dairy.

Maybe our witnesses could talk a little bit about just concerns about input cost, inflation, Waters of the U.S., how those might impact your dairies if those regulations are dialed up. Mr. Davenport, any thoughts about inputs and concerns about rules and regulations?

Mr. DAVENPORT. Yes. The input costs have always gone up since I have been milking cows. I mean, that is just a fact of life. Fortunately, we have gotten more efficient and learned how to feed the cows better. We can kind of counteract some of that.

Regarding the Waters of the U.S., I am all for clean water, and you know, and trying to keep it clean. I just think that we probably ought to not overburden the EPA with rules that they cannot possibly enforce. They do not have enough staff to run around and check everything.

I firmly believe that the algae bloom in the Chesapeake, the western part of Lake Erie, and the mouth of the Gulf of Mexico—I think we can do a better job. I mean, we are all cover crops. We do not have any soil that is open. We have highly erodible land, which the acronym for that, short of one L, but it is a tough farm when it is wet.

We basically have everything. Our soil stays in place, and we do use, you know, a little bit of herbicide. We do no tillage to speak of. We—you know. Dairy farmers are all about that because it is more profitable. You know? Wasting money on fertilizer? If it is not going to grow your crops, why bother? I think that is all laudable.

We just have to make sure that we do not have enforcement of rules, you know, sort of like if you have a vendetta against somebody you can pull something out of your pocket they cannot normally enforce for the whole industry. You know, it is the sort of thing where we just—we need sensible water cleanliness regulations, and we do not want to go overboard.

Senator MARSHALL. Thank you, Mr. Davenport, and thank you for sharing that farmers and ranchers are the greatest conservationists in the world.

I am sorry for going over my time, Madam Chair.

Senator GILLIBRAND. No worries. Our next Senator is Senator Fischer by Webex.

Senator FISCHER. Thank you, Senator Gillibrand, and thank you to our panelists today. Appreciate you taking the time to be here to give us some information that we find very valuable.

Mrs. Zuiderveen, in your testimony, you discussed that in 2020 with your Class III milk you received large gains as Class III milk prices increased. Meanwhile, you also mentioned that Class I milk prices fell. I appreciate your sentiment that we need to ensure a fair dairy pricing system. I have heard from producers in Nebraska who received negative producer price differentials because of the increase to Class III prices while the Class I milk prices fell.

You mentioned you are a member of a regional milk pricing reform committee. Have they discussed what recommendations would be most helpful for Congress to consider to ensure a fair milk pricing system? In particular, how can we address events like what we saw last year during the pandemic with negative producer price differentials?

Ms. ZUIDERVEEN. I will try and address as best I can. You did cut out a bit. The negative PPDs are experienced by lots of people, in fact, not just those with a blended milk price. We saw that on our check within the last couple months. This goes back to fundamental shifts in the milk market. We are no longer a fluid-based market. That market share has decreased by a lot over the last decades, and we really need to focus our production and our pricing more on the export market that has emerged, which is great for us. That trade and offering that market to our farmers is another area we can compete and earn more money.

Senator FISCHER. What do you think Congress should do? Is there anything that we can do to be able to ensure that we can address some of these events, like the pandemic, that would help producers?

Ms. ZUIDERVEEN. While I have been a part of some discussions, we do not have any public answers yet. I think there are a lot of great ideas out there, and I would love to see—some of our academic and processors that are on the next panel, I would love to see some of their ideas in this department.

Senator FISCHER. Okay. Thank you. You have also mentioned the impact that unpredictable pooling can have on producers' ability to utilize risk management programs like the Dairy Margin Coverage Program. This is a concern I have also heard from Nebraskans, who found the fluctuation in price caused by depooling made it difficult to use risk management tools like the DMC. Could you elaborate on how unpredictable pooling and price fluctuations can impact the effectiveness of risk management programs?

Ms. ZUIDERVEEN. Nebraska, I believe, is part of the Central Marketing Order, which Iowa is also a part of. The Central and Midwest Marketing Orders do not have nearly the fluid processing power as someone like the Northeast would have, and so they are under different rules. I think it is a lot harder to depool in the Northeast. If they had those same regulations within the Central and Midwest Marketing Orders, the cheesemakers just would not participate and the other processors would then have to pass on those negative PPDs to their producers.

Obviously, there needs to be some change in the milk pricing system, but it needs to be something that we all work on together so that it can benefit both producers and processors.

Senator FISCHER. Thank you very much.

Thank you, Madam Chair.

Senator GILLIBRAND. Thank you.

I have three additional questions that I am going to put forward, and each of you can answer them if you have an opinion. Over the past years, you have all seen your operation costs continually rise, whether those costs be for feed, fuel, or labor, and more often than not, the prices you receive for your milk hardly ever cover the cost of production. One of the pricing reforms that we are looking at is more closely aligning milk prices with the cost of production. Could each of you briefly explain the disparity between the current prices you receive for your milk and what it costs to produce the milk, and what are some additional ways that the prices you receive could reflect the cost of production?

Mr. DAVENPORT. Well, for my own operation over the last, oh, I do not know, 15 or so years, the price of milk exceeded the cost of production like maybe two. Of course there is an expression called "living off depreciation." That is a large part of it. Most businesses—well, it is a cost. Depreciation is a cost. You know, if you have some farm machinery that is fully depreciated, it still keeps working. You just got to fix it a little more, and it is a little less reliable. As a small producer, I do a lot of fixing.

I think I do not really know how you would align because everybody's cost of production is different. I think that any artificial subsidies to production anywhere make it hard to try to get a level playing field for everyone.

I sort of keep coming back to decoupling fluid milk price from volatile cheese and butter, powder. If we can come up with a way to price the most perishable, the least elastic in demand product that we produce, so that in the heaviest fluid markets they are not going to be hurt by crazy commodity price swings, and in the less heavily produced fluid markets that their cheese processors will still participate in the pool, I think it is just going to have to—somebody much smarter than I should come I would endorse a plan if I heard one I liked, but so far we have not.

I think that would be great to be able to do that because I—you know, the bottom line is, you know, you want businesses to thrive, and you want to be able to produce at a lowest cost possible, but the "too big to fail" thing I have seen happen in very large dairies in the Northeast, where the bank basically tells them: No more money. You take it out of your vendors, and they are the ones who are going to have to support you.

I have always paid my bills on time. I have a good line of credit, and I am not afraid to use it. I know there are some large operations that have outrun their ability to manage, that are just like a speeding train with no brake. I would like to see that, you know, they were not allowed to keep going when I have friends that are the same size that are doing really well and do just as good a job as I do with the cows and milk quality. I just would like to see these large farms that are out of control maybe get cutoff a little sooner to sort of teach everybody else that expand within your abilities of management. That is just something personal that I see.

Senator GILLIBRAND. Mrs. Zuiderveen?

Ms. ZUIDERVEEN. I would like to echo that I do not think subsidies based on the cost of production are going to be effective. Part of the beauty of living in the United States is that we have the freedom to take on things in a way that we want to. We can take on as much debt, build and expand to the size that works for us, for our families. Even between our three locations, we have different sizes of operations, and they all have different operating costs. We have different loans, different feed costs, and we milk different breeds of cattle based on where they are located and how much space they need. I would like to maintain that freedom.

There is no way that I should be told to make a decision based on someone else's farm or what someone somewhere else wants to happen. That is something I get to do based on each individual input in my operation.

Mr. FERGUSON. Senator, from my point of view, I agree with the other two that subsidies are not necessarily the solution to this. On a going-forth basis, we are going to be looking at a lot of changes that have to be made, improvements to protect the environment, to become more energy-efficient. I will say that grants and loans availability for operations that are undergoing these changes, and are doing it even on a voluntary basis, are a central part of the future of us maintaining viability.

Senator GILLIBRAND. The last question is about make allowances, processors are credited for some of the cost of processing certain dairy products, such as cheese and butter, through make allowances. Should future FMMO reforms include a make allowance for farmers to credit some of the cost of producing milk?

There has been criticism of the FMMO hearing process including the length of time required to request and hold hearings and implement changes. What are some changes that can be made to make this process more simplified and reactive to farmers' needs, if anyone has a thought?

Ms. ZUIDERVEEN. I do not know a lot about the make allowances. I think it is a pretty complicated topic. I do know that the changes that we make in the system, I would like to see them encourage innovation, and processors should have the freedom to expand and discover new markets so that we can continue to export, trade our product, and compete for the best price for our dairy producers.

Mr. DAVENPORT. The make allowance—I think that in some areas of the country there is a service provided to take extra milk and put it into a product that has a longer shelf life and can go into international market, providing those containers that wait a long—wait around long enough to get on the boat full of dairy products and not go back empty, but that is in my testimony, written.

I think that—you know, I think that somehow someone has to just keep an eye on make allowances and if there is something that is a little bit untoward for the dairy farmer that we can adjust them. Just how the mechanism I do not really know.

The second part of the question was? Sorry.

Senator GILLIBRAND. Whether you recommend any changes to the length of time required to request and hold hearings and implement changes.

Mr. DAVENPORT. Oh, yes. I think it would be nice to make the process move along faster. Never having participated in it myself, I probably should leave that to the economists who have some ideas on that. I believe that as long as that process has the input from all the concerns in the industry, that is very important. You know, I would rather see it take a little longer and be complete and done well than to be rushed and then have to go back and redo the whole process again. Thanks.

Senator GILLIBRAND. Mr. Ferguson, any remarks?

Mr. FERGUSON. Yes, Senator. As I think I mentioned earlier, as far as make allowances are concerned, it would be very beneficial in the Southeast to have a make allowance for help with the balance in cost because that is a huge issue in our marketing area.

The rulemaking process, sometimes it is a very tedious process. Could there be some efficiencies gained that would shorten that process? I would think that any operation that tells you that they cannot take—you know, by tightening things up, they cannot do just as good or a better job, I think they are kind of on the wrong page. I think that the process could be a little shorter because it is a very—as it stands now, it is a very frustrating process. Yes, I think there could be some shortening of the length.

Senator GILLIBRAND. Thank you. Thank you to our witnesses. Your testimony has been extremely helpful. If you would like to add anything additional to your testimony, you may write a letter to the Committee. Thank you so much.

We are now going to introduce our next panel. I will introduce them while they get settled. We will hear from Ms. Catherine H. de Ronde, Vice President of Economics and Legislative Affairs for Agri-Mark. We will hear from Mr. Robert Wills, President of Cedar Grove Cheese Inc. and Clock Shadow Creamery, and Mr. Christopher Wolf, the Baker Professor of Agricultural Economics at the Dyson School of Applied Economics at Cornell.

Catherine de Ronde is the Vice President of Economics and Legislative Affairs at Agri-Mark Dairy Cooperative. Catherine joined Agri-Mark in 2017 and is responsible for watching dairy market trends, forecasting milk prices, working on State and Federal legislation affecting Agri-Mark members. Catherine was previously employed as an agricultural economist with the Massachusetts Department of Agriculture Resources. Catherine holds a bachelor's and master's degree in resource economics from the University of Connecticut. Thank you for being here, Catherine.

Mr. Bob Wills is owner of Cedar Grove Cheese since 1989, founded Clock Shadow Creamery in 2011, and is a Wisconsin master cheesemaker. He served on the Board of the American Cheese Society and was Chair of the American Cheese Education Foundation among numerous other volunteer stints with dairy, sustainable agriculture, and community boards. Prior to buying the cheese factory, he worked as a research associate and instructor in the Department of Agriculture and Economics at University of Wisconsin, the Economic Research Services of the U.S. Department of Agriculture, and some State and Federal legislative staff positions. His academic credentials include a B.A. from American University in international relations and economics, a Ph.D. in economics, and a J.D. from the University of Wisconsin. Thank you, Bob, for being here.

Then Dr. Christopher Wolf is the E.V. Baker Professor of Agricultural Economics in the Dyson School of Applied Economics and Management, Cornell University. He moved to Cornell in 2019 after more than 21 years on the faculty of Michigan State University. He conducts research, extension, and teaching focusing on dairy market and policy, farm business management, risk management, farm animal welfare. Dr. Wolf has published widely in academic and industry outlets. His extension program stresses the effect of public policy on farm behavior and final outcome, aiming to focus on issues of current and future importance to policymakers and industry decisionmakers. A native of Wisconsin, Dr. Wolf received his bachelor's degree from the University of Wisconsin and his Ph.D. from the University of California-Davis. Thank you for being here, Dr. Wolf.

Again, I thank all of our witnesses today. As a reminder, we ask that you keep your testimony to five minutes each, and your written testimony will be submitted for the record, as you may hear me tap the gavel should your time expire.

Ms. de Ronde, you are recognized for five minutes.

CATHERINE H. DE RONDE, VICE PRESIDENT, ECONOMICS AND LEGISLATIVE AFFAIRS, AGRI-MARK INC., ANDOVER, MASSACHUSETTS

Ms. DE RONDE. Chairwoman Gillibrand, Ranking Member Hyde-Smith, and members of the Subcommittee, good morning. On behalf of the 720 Agri-Mark dairy farmers, thank you so much for spearheading this hearing and for the opportunity to testify before you today. It is a great honor to share the voices of my farmer members.

Milk pricing is front and center for our farmers, particularly with the year we just lived through. We applaud you for your continued support of our dairy farmers and industry and greatly appreciate your efforts to secure the latest Pandemic Market Volatility Assistance Program as well as the Dairy Margin Coverage adjustments. Your involvement and your leadership is why I am here today and why it was so important for Agri-Mark to be a part of this hearing.

As was mentioned this morning, dairy farmer—dairy farming is a 24–7 commitment 365 days a year. Besides the physical labor, the mental and financial side can be equally draining. As our Nation and global economy have evolved in recent years, the issues facing today's dairy farmers are far more complex than what was faced by generations of farmers before them. Our dairy farmers are resilient, but they are not impervious to these compounding forces.

Today's challenges encompass the impacts that global trade has on our markets, labor pressures at all levels of the supply chain, and changes in consumer desires. Together, they have placed a tremendous amount of stress not only on our dairy farmers but supply chains and their cooperative businesses as well. Collectively, we must work to ensure that our dairy supply chains are strong and viable, starting with our dairy farmers. Dairy farmers help feed America, and they are playing an increasing role in providing sustainable nutrition to the world. Our dairy farmers are critical to our local and regional economies, creating jobs, conserving land, and supporting local food systems. We must ensure that they have the markets, programs, and tools to continue to operate and be sustainable for generations to come.

At Agri-Mark, I engage with our members every day, discussing the current marketplace and forecast. Milk pricing is something that our farmers are particularly concerned about and something that Agri-Mark is actively working on to improve on a national level. Our cooperative is a member of the National Milk Producers Federation as well as the International Dairy Foods Association. I serve on the Economic Policy Committee of each organization, both of which are working on milk pricing and policy issues. In 2019, both of these committees started a deep dive into widespread pricing reform conversations until the pandemic put an abrupt halt to those efforts.

Last year's extreme volatility and unique market circumstances unveiled underlying flaws in our Federal Order system and drew acute attention to three key elements: negative producer price differentials or PPDs, depooling, and the Class I mover. For farmers, this showed up as unfamiliar milk checks, causing a lot of unease, misunderstanding, and many questioning if the system was working properly or not, and it gave the industry an even greater urgency to revisit the need for Federal Order reform.

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

As we work to improve Orders, it is critically important that we recognize the intersections in milk pricing and how a change in one area can have an impact and change another. In this context, the current Class I mover has caused significant depooling and substantially reduced producer revenue, which was not intended. This needs to be addressed.

While I deeply and personally understand the urgency to resolve our challenges, thorough analysis of these intersections, considering all perspectives, is essential to guaranteeing reform success. Changes should be made through the formal rulemaking process to ensure that a comprehensive approach is taken and that producer, processor, and consumer voices are heard and considered.

There is much work to be done to evolve this Federal Order system, and the industry is on board and hard at work. We must continue to strengthen pricing mechanisms, provide aid to all farmers when needed, and build consumer trust domestically and in emerging markets across the globe. This hearing is an important step in the early stages of this dialog. Once again, I thank you for your advocacy, investment in our industry, and once again, the opportunity to share my thoughts with you today.

[The prepared statement of Ms. de Ronde can be found on page 53 in the appendix.]

Senator GILLIBRAND. Thank you very much. Mr. Wills, you are recognized for five minutes.

STATEMENT OF ROBERT WILLS, PH.D., PRESIDENT, CEDAR GROVE CHEESE INC. AND CLOCK SHADOW CREAMERY LLC, PLAIN, WISCONSIN

Mr. WILLS. Senator Gillibrand, Madam Chair, thank you for the opportunity to address the Committee today.

My two cheese factories are supplied by about 28 farms. Ten years ago, when I started Clock Shadow Creamery, the green cheese factory in Milwaukee, I decided that we would be supplying consumers throughout the State. I have always viewed my role as supporting dairy producers who supply milk to our factory as well as supporting the health and safety of our consumers, but today I fear for the future of the dairy industry.

The subject of today's remarks is tough to condense, but let me try in just a few sentences. federally administered milk pricing established by Congress now functions opposite of its intent. Our Federal Milk Market Orders have features that cause higher dairy prices for consumers and create lower milk prices for farmers. The Order system responds slowly and inadequately to changes in cost and demand shocks, and encourages inefficient trucking and location of dairy facilities, and the complexity of the system creates opportunities for anti-competitive behavior and promotes consolidation. Here is the thing; the 90-year-old structure of the Orders creates the problems I noted below, but the outside pressures today are exposing how this system threatens the continuing existence of dairy farming in the United States.

Today, the dairy industry faces increased international competition. We face rising costs and uncertainty from climate change. We face disruptive bio-culture technologies that threaten to produce dairy ingredients from genetically engineered microbes. Milk pricing administered in the Federal Orders has not been able to evolve to fairly address the changing dairy industry, and this old mechanism definitely has no tools to address global competition, the need for more sustainable production, and disruptive self-cultivated replacements. The survival of the dairy industry depends on your decision to end the rigidities of the Market Order system as soon as possible.

Originally, Milk Market Orders were intended to get nutritious fluid milk to consumers, especially children, throughout the country. In practice, the Orders raise the price of fluid milk and pay farmers to dump milk, a horrible practice that is disrespectful of the animals, hardworking farmers, and hungry citizens.

In the heart of—the heart of the system is milk pricing. Milk is priced by class. A pool from the premium added to sales of bottled milk is shared among farms that ship to manufacturers of yogurt, cheese, and butter, and milk powder. Farmers are only better off if that premium on fluid milk exceeds the value the loss in value from lower prices in the other classes. Plus, inefficiencies are created by the process. Precise conditions are required for the monopolistic market segmentation to increase the overall value of milk. Although the redistribution system makes it appear that all farmers are winners, evidence suggests the classified pricing reduces total milk—total farm revenues.

Federal Milk Orders are immensely complicated. Eleven different regional Market Orders have different prices and rules, and changing a single regulation and Order requires a costly hearing process that stretches on for years. Large companies and cooperatives unnecessarily transport milk to take advantage of price differences among Orders. Order shopping gives those large companies a competitive advantage over regional processors. Their superior understanding of the intricacies of the system and the ability to take advantage of regional differences gives big companies a stake in continuing the Market Order system.

The dairy industry has worked around the fossilized structure of Federal Orders for decades, but new challenges are coming that require efficiency and innovation that the Orders prevent. Milk pricing in Federal Orders has zero provisions to recognize costs associated with exporting dairy products or the ability—or the added cost of developing unique, new products tailored to the taste of consumers in other nations.

The newer challenge facing this old dairy system is imitation or clone dairy products. Plant-based milk substitutes, such as soy and almond drinks, provide an important alternative for people who are unable to consume dairy. The sales of these products have grown, but only a small amount of consumption has seemed to replace milk.

The next wave of fermentation-based technologies, using genetically altered microbes, to produce specific dairy proteins in large tanks—as unnatural as that sounds, business startups are attracting large investments from international investors. These companies have dabbled in products like animal-free ice cream, but the first really large threat they pose is large-scale production of mimicked whey protein, the by-product from cheesemaking. Without a whey market, cheese plants would struggle to make a profit, would have fewer dollars to pay dairy farmers, and would face the environmental challenge of disposing of perfectly good whey. Beyond replicating individual proteins, some entrepreneurs even claim to be able to copy milk exactly by using cloned mammary cells.

None of these challenges to milk sales, including international competitors and processors of vegetable analogs or biotech replacements are saddled with the burden of conforming with Federal Milk Marketing Orders. Our farmers should not lose the competition just because they are not allowed to compete fairly.

[The prepared statement of Mr. Wills can be found on page 59 in the appendix.]

Senator GILLIBRAND. Dr. Wolf, would you like to give five minutes?

STATEMENT OF CHRISTOPHER A. WOLF, PH.D., E.V. BAKER PROFESSOR OF AGRICULTURAL ECONOMICS, CHARLES H. DYSON SCHOOL OF APPLIED ECONOMICS AND MANAGEMENT, CORNELL UNIVERSITY, ITHACA, NEW YORK

Mr. WOLF. Chairwoman Gillibrand, Ranking Member Hyde-Smith, and members of the Committee, thank you for inviting me to be part of this hearing.

The U.S. dairy industry is diverse in terms of farm size, production technology, geography, and markets served. Major trends that influenced the industry in recent years include changing consumption patterns, the rise of international trade as a major outlet for U.S. dairy products, and consolidation at all levels of the supply chain.

Federal Milk Marketing Orders, using multiple component pricing, which handle the majority of production in the country, pay farmers based on component value plus a producer price differential that reflects the pool value in excess of the components. In 2020, record negative producer price differentials occurred, which were not just abnormal in magnitude; they were unpredictable and greatly contributed to farm milk price volatility. Recent research found that the large declines in producer price differentials were caused by a whole host of factors, including trends in utilization, driven by consumption trends, trends in milk component production, the change in Class I skim milk pricing mover, and depooling of milk by Class III processors.

The impact of each of these factors varied both across Federal Milk Marketing Order and over time. The regional impacts depended on utilization, processing capacity, and other market factors. On average, across Federal Milk Marketing Orders, the largest impact contributing to negative producer price differentials in 2020 was depooling of milk while another significant impact was the aforementioned Class I pricing change. Both of these factors were exacerbated by the historically wide divergence in Class III and Class IV milk prices in 2020 due to the change in consumption from food away from home to almost exclusively at home, as well as government purchases of dairy products.

With respect to consumption, beverage milk consumption has trended downward on a per capita basis, with the rate of decline increasing since 2010. In contrast to beverage consumption, cheese, butter, and total dairy product consumption have been growing. The rise of exports has coincided with increasing U.S. milk production. Since 2005, dairy exports have grown from accounting for about five percent of milk production to currently accounting for more than 16 percent. Export markets assist in balancing the production of butterfat and milk proteins. There are farm milk price implications of growing dairy exports, including the influence of international supply and demand factors, as well as the political impacts of trade.

The issues that motivate this hearing relate to farm milk pricing under the Federal Milk Marketing Orders. When the Orders were created, the majority of milk in those Orders was used in fluid products. Shrinking relative share of Class I, or fluid consumption milk, means that there is less money in the revenue pool. Given the age of the Federal Milk Marketing Order system, the length of time since the last major reform, and changes in the market from both the production and consumption sides, it is likely time to reexamine aspects of the Federal Milk Marketing Orders. Issues that are widely regarded as in need of attention at this time include the Class I mover and make allowances.

Class I milk pricing methods were changed in the 2018 Farm Bill and implemented in 2019 to make the Class I skim milk price mover be the average of Class III and Class IV advanced skim milk price, plus a fixed 74 cents, rather than the higher of those advanced prices. The 74-cent per hundredweight differential was chosen to be revenue-neutral. One implication of this rule change is that when the difference between Class III and Class IV advanced skim milk price exceeds $1.48 per hundredweight the resulting Class I price built from this new formula is less than it would have been using the higher-of.

Price differences of this magnitude were not unheard of previously, but the pandemic resulted in a wide and prolonged divergence in Class III and Class IV prices in 2020. This large divergence in butter and cheese prices meant that the Class III milk—Class I, excuse me, milk prices were lower than they would have been under the former pricing rule and focused attention on this aspect.

Make allowances are the amount of the wholesale dairy product price that accounts for the manufacturing costs when calculating the component farm value of milk. All else equal, increasing the make allowance for a product such as cheese or butter means the amount of the wholesale dairy product price that is passed on to farmers is lower. If make allowances are inadequate, however, processors with higher costs will either be driven out or must make up the difference elsewhere.

The entire supply chain, from farmers to processors, must be healthy for a prosperous dairy industry. The current set of markets and institutions that we have has evolved around the existing Federal Milk Marketing Order system, and the ripple effects of reforms should be carefully considered to balance the interests of all involved parties, including equity as well as economic efficiency.

Thank you for your time, and I look forward to any questions or comments you might have.

[The prepared statement of Mr. Wolf can be found on page 69 in the appendix.]

Senator GILLIBRAND. Thank you, witnesses.

Ms. de Ronde, I know that Class I is the only milk class required to participate in the Federal Milk Market Order pools, but the new pricing method and depooling clearly caused disorderly marketing conditions for farmers last year. Can you talk more about this? How were producer risk management tools impacted?

Ms. DE RONDE. Yes, and thank you for the question. I think there is really three parts to that. The first one, you asked about Class I being the only class that is required to participate in the pool. You know, as was mentioned here, our Federal Order systems were designed for a fluid marketplace and pooling revenue to make sure that every farmer is equal. In order for that to work, Class I needs to participate in that because traditionally Class I has been the highest price. It is absolutely essential for at least how the Orders were designed, if we want to have pooling, we need to make sure that Class I participates.

To get to your second question about disorderly marketing, disorderly markets caused by the pandemic—Chris, I think you just did an excellent job talking about that, but I will just sort of echo some of those comments there. When we had an extremely fast rise in Class III prices due to the pandemic, crashing prices and then the food box program coming in and recovering those Class III markets, it was that rapid rise that got us into an unfamiliar pricing relationship. It caused the Class III price to exceed far beyond what we had ever really seen, and the difference between the Class III and Class IV became extremely wide and, as was mentioned, was not—was so wide that the new pricing mechanism with the Class I had not intended for that to happen and did not account for that, and producers were not revenue-neutral.

To your last question about risk management, when this takes place, when we have volatility in the marketplace, that makes it extremely hard for a producer to make an accurate risk management decision. Producers make risk management decisions based on what they think the futures markets might do and, you know, what traditional relationships may look like. What we saw last year was really an anomaly, and producers' risk management decisions were not based on the anticipation of a food box program or a COVID pandemic happening. Just generally, that market volatility was what drove some really significant challenges in risk management decisions.

Senator GILLIBRAND. Mr. Wills, we know that FMMO pool deficits from depooling affected producers. How were different processors affected in terms of profit and loss? What would you recommendation be for reforming and updating pooling rules?

Mr. WILLS. Well, I think as I indicated, there is no other industry that is priced like this, and my recommendation would be to eliminate the pooling rules because I do not believe they are actually increasing the value of milk overall.

On the other hand, depooling, the option of depooling is absolutely necessary if you are going to keep people in business. Depooling is pressure relief when the Market Order forces companies or would put companies in the position of having to pay a higher price than what they have earned for their products.

Now you know, the bizarre thing, of course, in milk pricing is that today or yesterday I learned what the milk cost me that I bought August 1st and my producers will find out tomorrow when they receive the checks what they got for the milk that they produced August 1st. That delay system is what creates the negative PPDs and puts people in a position where they both cannot make good planning as to where their—as to how to run their businesses and how much milk to produce, but also forces them to have that option of depooling at times because the prices are not reflective of value.

Senator GILLIBRAND. Dr. Wolf, based on your years of research and analysis of Federal milk pricing what suggestions do you have on pricing reform that would help farmers receive a fair price for their milk? Given falling prices and volatility, how can small dairy farmers survive in this environment? What policies could be implemented to help?

Mr. WOLF. Thanks. Yes, well, I think updating the Federal Milk Marketing Orders to reflect some of the current realities of the market are very important if we are going to continue to have this system be the foundation.

I think it is important to also consider the fact that the farm milk prices built up from several components. The farm Milk Marketing Orders—the Federal Milk Marketing Orders, excuse me, are a major part of it, but the regional and cooperative aspects are another part of it. Part of what has been driving the volatility has been kind of the differential experiences from the market access and the—what has been going on in the different product markets around the country. That has been greatly contributing. What we have seen is at the farm level there is a pretty wide variation in the price received, and you know, 2020 was a particular stark demonstration of that as some farms seemed to weather it pretty well and others were devastated by the market situation that they had.

You know, I think the biggest thing that can help the smaller farms, to the extent that we want to consider that, is to make certain that they continue to have market access, that they continue to have bargaining power to the extent that they can, and that they have the market information they need to make the proper decisions. That is actually one place that I would argue that the Federal Milk Marketing Orders are pretty important is in providing leveling market information for everybody to have.

Senator GILLIBRAND. Thank you.

Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair.

Dr. Wolf, did you see the article that Secretary Vilsack wrote last week regarding stepped-up basis?

Mr. WOLF. Yes, sir.

Senator BOOZMAN. Okay. In that article—and again, correct me if I am wrong, but my reading of it was that, he essentially said that the only people that would be affected by stepped-up basis would just be a handful of corporate farmers and that everybody else, it did not matter, and that he felt like they should go forward with stepped-up basis. Is that correct?

Mr. WOLF. Well, if I remember correctly—I am sure that you are right. If I remember correctly, I think he said something like two percent would be affected.

Senator BOOZMAN. Exactly.

Mr. WOLF. That is of the USDA's number of farms.

Senator BOOZMAN. Exactly. We have asked USDA for that information to back that up, and it is silence. The only reason I say that is we have had others say today that stepped-up basis is over, but you have the Secretary of Agriculture coming out as recently as last week saying: No, we need to push forward with this.

According to a study completed by Texas A&M University, on the impacts of the proposed changes to stepped-up basis on representative farms, Texas A&M found that the Northeast would be subject to hundreds of thousands of dollars of increased taxes. In your review of farm financial data, can you share what impacts these additional tax liabilities, in your opinion, would have on dairy farmers in the Northeast?

Mr. WOLF. Sure, Senator. I am not an expert on this topic. I have no reason to distrust the analysis that Texas A&M did, and I have not done detailed analysis myself.

I can tell you from working with farms on farm business management that estate planning is—to bring the next generation is a very large challenge for—you know, especially for commercial farms. Modern agriculture is very capital-intensive, and farmers do not tend to be overcapitalized because it is expensive to be. They do not tend to have more capital than they need, but they certainly need enough capital to make a living. You know, it is not the same as passing on non-business investments. I can see that that would be a significant concern for farmers, to make certain that they could make the next generation viable.

Senator BOOZMAN. Right. Dr. Wolf, you are one of the leading dairy economists in the country. Have you recently provided any academic input to policymakers in the development of the $135 billion in agriculture reconciliation provisions with regard to what might best address the specific needs of dairy producers and the dairy industry?

Mr. WOLF. No, Senator, I have not.

Senator BOOZMAN. Okay, which is sad. If you had that opportunity—I want to give you that opportunity now. You mentioned market access and things. What suggestions—summarize for me. This has been such a great hearing. Tell us in your opinion some of the most important things, if you could give that advice, which you are now. What do we need to be doing to make things function better?

Mr. WOLF. Well, Senator, I think that there are a lot of opportunities to help the dairy industry. In particular, the issues that they are struggling with right now largely have to do with input costs, with the labor situation in particular, with feed costs. Market access is a big issue. Then the one that is kind of looming that everybody is going to need to deal with at some point probably relates to greenhouse gases and environmental change. I think that, you know, there are many opportunities there too, both in the research side and helping at the farm-level side with, you know, making certain that farms are resilient and that they are contributing to the solution, you know, of the problem because I think U.S. farms can be a big part of the solution there.

Senator BOOZMAN. You mention input costs. With the inclusion of the Green New Deal and significantly increasing gasoline prices, which again with delivery is such an important part of dairy and just operating the farm, rural America, gas prices, electricity prices. What would that do to the input of our dairy industry?

Mr. WOLF. Energy costs are very important for the dairy farmers because they use a lot of energy, both in milking cows but also in producing crops. I also think, if I might add, that you know, to the extent that we take advantage of the potential gas production from dairy manure and others, that they could be benefiting from the energy markets there as well.

Senator BOOZMAN. Very good. Thank you, sir.

Thank you, Madam Chair.

Senator GILLIBRAND. Thank you.

I think that is all we have. No. Senator Marshall, you are here. Thank you.

Senator MARSHALL. Thank you, Madam Chair. I will start with Ms. de Ronde. You represent 700 farm families. What would be the impact of stepped-up—losing stepped-up basis and cutting the death tax limits in half to those families over their future?

Ms. DE RONDE. Let me just talk a little bit about what our membership looks like. 720 members, very diverse. We range from a five-cow Amish farm to—all the way to, you know, over 1,000-head. One thing that is incredibly important for us as a cooperative is sustainability and sustainability of the next generation to come. We work incredibly hard to foster relationships, provide professional opportunities for our young farmers, to make sure that they are ready to be that next generation for us. You know, we worry about what opportunities they have and what challenges are going to be before them. Anything we do that is going to impact their ability to continue to farming on the land that their families have been on for generations is going to be detrimental to the next generation.

Senator MARSHALL. Being a fifth-generation farm kid myself, I mean, I would suppose if we would lose the stepped-up basis we would have to sell a third of our farm to pay the taxes. Is that a fair statement, that people would have to sell land in order to pay the stepped-up basis and the dairies would be getting smaller rather than bigger?

Ms. DE RONDE. We have not looked at in detail what the impacts of that would be in terms of how much land we would lose, farmers, et cetera, but we do know that it would have a massive impact.

Senator MARSHALL. Yes. Thank you.

Mr. Wills, you make cheese, right?

Mr. WILLS. Yes, sir.

Senator MARSHALL. I am not sure how many producers you are involved with, but I bet there is a place in town where you guys go and have coffee together, and maybe when they bring their milk to you guys you have a place to share a cup of coffee. If those farmers/producers were here today, or when you sit down with them, what are their biggest concerns when it comes to agriculture going forward?

Mr. WILLS. You know, I think for a lot of my producers they tend to be smaller producers, and I think a lot of them are concerned about continuing to have access to the market. As the buying industry consolidates, that they are—even in Wisconsin, where there is more competition probably for dairy than in most of the country, there have been incidences where we have had a very hard time finding homes for some farmers who have been cut loose by the bigger plants. There is a tendency for the big plants to only want to pick up milk from places where they can get an entire truckload of 50,000 pounds of milk rather than from making a lot of stops at small places.

Now you know, the impact of losing all those producers, we have gone from 140,000 dairy farmers in Wisconsin down to fewer than 7,000 now, and we are losing about 10 percent a year. That just hollows out the communities. When you are talking about sitting down and having coffee with the producers, there is not a restaurant in town anymore to have a coffee at. You know, we have lost our hardware store, our grocery store, and a lot of it has to do with the rural communities being hollowed out. You know, the ability to maintain and support small farmers is not only important for those farmers but also for our communities.

Senator MARSHALL. Thanks. Well, certainly as agriculture goes, so goes rural America.

Dr. Wolf, I will probably finish up with you with a question. The Federal Milk Marketing programs that have come out for the past couple years, just in a broad stroke, what has the impact been on small producers versus larger producers, and is there fairness there in your opinion as an economist?

Mr. WOLF. Well, the Dairy Margin Coverage Program is very much aimed at the smaller producers, and I think in particular with the changes that have been made recently it is much better for them. You know, so I kind of look at it as the Dairy Margin Coverage Program more aimed at small-sized and dairy revenue protection and Livestock Gross Margin Dairy Programs for the bigger farms. I think that, you know, with those two programs in place we are in a pretty decent situation from a risk management point of view although, you know maybe not necessarily for what was hopefully a once-in-a-lifetime pandemic.

Senator MARSHALL. Well, would you agree with me that the small producers are much more—been successful from the programs and the bigger producers have not had much help through these tough times?

Mr. WOLF. Well, maybe the—certainly, the bigger ones get less relative help from like the Dairy Margin Coverage Program, but the bigger herd operators are also much more likely to be doing their own risk management programs like Dairy RP. If they had that in place entering 2020, then they probably did pretty well from that.

Senator MARSHALL. Okay. Thank you so much, Madam Chair.

Senator GILLIBRAND. Does anyone have any additional questions and anyone on Webex?

[No audible response.]

Senator GILLIBRAND. Well, I want to thank our panelists for your excellent testimony. If you would like to supplement your testimony in any way, please just submit it to the Committee. With that, our hearing is adjourned.

[Whereupon, at 11:34 a.m., the Subcommittee was adjourned.]

A P P E N D I X

SEPTEMBER 15, 2021

MMB Testimony

~ September 15, 2021 ~

Good morning, I'm Jim Davenport. My wife, Karen and I have a 64 milking cow dairy in Ancramdale, NY. The farm is about two hours north of NYC and 1 ½ miles west of the New England border. We are members of the AgriMark Dairy Cooperative and one of nine farmer owners of our Fluid and Class II processing company called Hudson Valley Fresh. We own our plant, located in Kingston, NY, which is a pooled plant in Federal Order One. We have about 300 direct store delivery customers in the Hudson Valley and many more customers in the NYC metro area and Long Island served by our distributors. We supply all of the dairy products used by the United States Military Academy at West Point.

I would like to thank Senator Gillibrand for her support of the largest agricultural sector in New York State and its dairy farmers. We appreciate her work to make the DMC more responsive to the needs of New York dairy farmers. On our dairy, where we feed a high level of homegrown forage and not much purchased grains, these insurance payments have helped immensely. During the most extreme Covid related market upsets, the CFAP direct payments kept many dairy farmers solvent and we are grateful for that support.

We, in the dairy business, have felt multiple headwinds over the past several years. Thanks to misinformation on social media and online, consumers are turning away from dairy to nutritionally inferior, often less sustainable substitutes. This has hurt our fluid milk sales and nourishment of consumers, particularly children whose development depends on the naturally produced, metabolizable nutrients that real milk provides.

Unfortunately for us dairy farmers and fortunately for the consumers of dairy products, we are really good at what we do. This is a result of applied research from our land grant universities and Cooperative Extension Educators who help bring progressive, efficient and timely information to farmers.

The Covid Pandemic and its Effects on the Dairy Food Chain

As both a dairy farmer and processor, I have had a first hand view of its effects on the dairy food chain, the Federal Order System and classified milk pricing as well as the value of belonging to a Cooperative. As a member of an American industry that can compete globally in the export market, I feel I should point out the current Covid induced problems in our sector. The Covid Pandemic exposed the weak links in the food chain, probably none so much as in the fluid milk supply chain. As we all know, Class I fluid milk is the highest valued of all the classes of dairy products. It is the most perishable and must spend the least amount of time between the cow and the consumer.

We, the AgriMark members of Hudson Valley Fresh, are actually customers of our own cooperative. We receive our milk checks without fail on the 5th and 20th of each month from AgriMark for our preceding months production. By the 20th, AgriMark has received the final pay price from the Federal Order 1 market administrator and can pay based on all of the price information the Order has received. This includes what we report from our Federal Order 1 pool plant in Hudson Valley Fresh Kingston. Twice a month Hudson Valley Fresh sends a check to AgriMark paying the Class 1 price. Monthly we send a check to the Federal Order to pay for the services they provide us. The reason for this seemingly nonsensical scenario is simple. We are currently processing milk four times per week. We get orders in for a processing run and the idea is to take in only the raw milk we need for that day. Any milk our nine farms produce in excess of that day, AgriMark finds another processing plant to use it. During the extreme disruption of Covid we had one distributor in NYC go from taking three full tractor-trailer loads of crates of milk per week to ZERO loads on March 16, 2020. All of this milk went back into the AgriMark system. This saved the Hudson Valley Fresh farmers from ruin and shouted out the value of paying the highest class price for our own milk. It did however create a problem for AgriMark. At the same time all of the other fluid processor customers were doing the same thing and AgriMark, in spite of running our Butter/Powder (Class IV) plant at greater than 100% capacity and all of our Cabot and McCadam cheese plants at the same level, we were losing huge amounts of money paying for surplus milk that had no value. AgriMark had to establish a Covid base plan that required all producers ship less milk. On our farm, rather than upsetting the cows, who were clicking along just fine, we made about 35,000 pounds (about 4,000 gallons) of high quality fertilizer. We actually pumped it into our manure storage tank! A vast majority of AgriMark farmers understood that this was the best course of action our Co-op could take as we could see no future without AgriMark marketing our milk. One other benefit of being Class 1 customers of our own Co-op is that AgriMark handles all compliance with phytosanitary and other regulations that raw milk must meet. Add in the fact that there are premiums to members for high quality milk and a Quality Producer Recognition Program that we use to help market our Hudson Valley Fresh Brand; belonging to AgriMark is a “no-brainer”!

The Federal Order System

As a Federal Order producer since 1986, I have a decent idea of how the system works. There were 249,190 dairy farms when we began with an average of 43 cows per herd. At the end of 2020, there were 31,657 licensed dairy farms with an average of 300 cows per herd. In 1986 United States dairy farms produced about 145 billion pounds of milk. In 2020, we produced 223 billion pounds of milk. In

1986 we were a larger than average sized herd. Today, the average herd is about five times larger than ours. This points out the fact that smaller herds are disappearing. Due to economies of scale, labor efficiency and a host of other factors, large farms are more readily able to keep their cost of production at or below the price of milk. On our small dairy farm, we rarely have the “pay price” for our milk, exceed our cost of production.

In the past when there was less consolidation in the fluid processing business and many smaller fluid plants, the producer had many options available. Some chose to be independent producers, some became Co-op members that sold Class 1 milk to processors. Some processors would secure the majority of their milk supply from independent producers and balance their needs with Class 1 milk from Co-ops. Prior to 1980, the three Federal Orders that were merged to become the Northeast Order had over half of the producer milk used in Class I. In the 30 years from 1980 to 2010, Class I utilization slowly dropped from the upper to lower 40% range. In the 10 years since then it has plummeted to through the 30% range, standing in 2020 at barely over 30%. One of the valuable services that a multi-product processing cooperative like Agri-Mark brings to its members, and the market in general, is balancing the variable demands of Class I processors versus the supply of milk. The AgriMark Butter/Powder plant in West Springfield, MA was built to do just that. Sometimes, during periods of excess milk it ran at full capacity. During times when the milk supply was tight relative to the demand from Agri-Mark customers, it didn’t produce enough product to cover its cost of operation. There was a protracted period of low volume into the West Springfield plant that we even considered closing it. The farmer members of AgriMark shouldered these losses as we knew how important the plant had been in times of need and how important it was to ALL the Northeast dairy producers to have it there in times of surplus.

During this period of time, the Federal Order system ensured that producers received at least the Federal Order prices and were paid on time and in full by their handlers. The Blend Price the farmer received was always calculated by all the prices obtained through reporting to the Federal Order 1 Market Administrator’s office by the plants in the order. A profusion of data is collected to determine these prices. Each pool plant in the order pays a service fee to the market administrator to cover the cost of this work. The Covid pandemic exposed the weaknesses of the price discovery mechanism. The current pricing system for fluid milk from the 2018 Farm Bill was agreed to by producers and fluid processors. It took the average of Class III and IV prices over a period of years and added $.74/cwt to arrive at the class I price. If we, the producers, had foreseen such an insane disruption in product prices as the Covid pandemic caused, we would never have agreed to the change. If we had been using the previous higher class III or IV price plus a fixed differential, it would have resulted in less negative Producer Price Differentials and better prices to farmers. The 750 million dollar hit to us would have been greatly reduced.

I am no economist, but I feel that the current pricing system is helpful to processors because thanks to the maturing cheese and butter/powder futures markets they can hedge to protect against price swings. For the producer, some kind of safety valve against huge product price swings like we saw with Covid could be worked into the calculations. Also, continuing to add data regarding prices over time, while tossing out "outlier" product prices from the equation would be beneficial.

To small farmers like us, and especially those who have no chance to capture more of the consumer with value added retail sales, I feel completely eliminating the Federal Order system would be suicide. There would be chaos in the marketplace. As I indicated before, raw milk must leave the farm's bulk tank at 38F degrees every 48 hours. It must stay cold until pasteurization, then be brought back down to 38F degrees and be kept cold until used by the consumer in fluid milk sales.

Without a Federal Order system to provide order in the marketplace, farmers could not be sure of a home for their milk or that a fair price for their labor be paid.

Unfortunately, always striving to be more efficient, the dairy producer is often in an oversupply situation. The large processors that are the norm today could secure, at a low price, most of their needs from the largest producers and procure the remainder of the milk needed, for a pittance from desperate producers with no other place to sell their milk. The perishability of milk makes it unique in the world of agricultural commodities. It is critical to have order in the marketplace that the Federal Order System provides.

The Importance of Exports to the United States Dairy Industry

As I have said before, as an industry we are good at what we do. We are one of the few large United States industries that compete on price in the world market. We have the ability to sell our product to countries that need the nutrition in our dairy products for their consumers and the money to pay for it from their exports of manufactured goods to the United States. Trade wars that have shown few positive outcomes have hurt US exporters, particularly agricultural producers. Covid has only exacerbated this situation. Containers travelling overseas are usually filled with US agricultural products, including powdered milk, powdered whey, cheese and butter. During the pandemic, instead of being filled with agricultural products, they are being rushed back from the U.S. empty, to be filled with trade deficit building goods that homebound, financially secure Americans are splurging on. In order to allow the dairy industry to continue to provide the world with more nutrition free and unhindered trade is essential.

Conclusion

In conclusion, I hope you were able to understand the dairy situation from a small producer and processor - me. I believe the take away from my testimony can be summed up in a few points:

- The product mix in dairy has changed
- The dairy industry gets better at what we do everyday
- Free and unfettered access to trade is critical to the ever more efficient and productive U.S. dairy industry.
- The nutrition dairy provides is essential for people domestically and globally.
- The Federal Order system has done a good job in the orderly marketing of milk for a long time.
- The Federal Order Class I price discovery system needs adjusting to current market conditions and the current product mix.
- Co-ops provide a service to their membership as well as to the entire marketplace.
- And finally, with the consolidation in the fluid milk processing business, small farms depend on the Federal Order System to help them survive.

Thank you for your attention and time, Jim Davenport

Testimony of Christina Zuiderveen before the United States Senate Committee on Agriculture, Nutrition, and Forestry Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security

Good morning, it is an honor to be here representing the many dairy families in Iowa and across the United States. Chairwoman Gillibrand and ranking member Hyde-Smith thank you for giving me the privilege of taking part in our governing process.

I was born into a California dairy family who chased better market conditions into Michigan in the mid-90's. After we were married, my husband and I spent 2 years working on his family's 500-cow dairy before taking an opportunity in an emerging dairy market, the Central Plains, where we have lived for nearly 10 years. I live with my husband and our three children in Northwest Iowa, but we also work closely with my brother in Southeast South Dakota. Together, across three locations, we milk 15,000 cows.

I currently serve on the board of the Iowa State Dairy Association. ISDA has partnered with my co-op, EDGE, to form a regional milk pricing reform committee of which I am also a part. This committee has worked with several state associations to discuss ideas to reform milk pricing in a way that is fair for both dairy producers and processors across the Central and Midwest marketing orders.

Most milk in the United States is produced in areas regulated through Federal Milk Marketing Orders (FMMOs). This system was put in place decades ago to prevent dairy processors from making one dairy farmer bid against the other. In other words, FMMOs promise dairy producers that if their milk is as good as their neighbor's, they will be paid the same price. But, after decades of decline in sales of fluid milk, that promise now seems to be broken. Although these conditions benefited me personally last year, I am advocating for change because I want a fair system where everyone can compete on a level playing field.

In 2020, cheese prices were very high. We ship our milk to a cheese processor, so our milk price was high, and we were able to pay down debt and grow our operations. Meanwhile, some of our neighbors were forced to implement cost-cutting measures to stay afloat. I have spoken to dairy farmers all across Iowa who are struggling because they are paid far less for their milk because they are not paid solely on the cheese price. Our prices are most definitely not uniform.

This disparity is not unique to my region. I have family in California, Indiana, and Michigan who face the same problem. On the surface, it seems that pooling rules are the problem that led cheese processors to pull unprecedented volumes of milk out of FMMOs last year. But the deeper issue is that FMMOs do not provide market-based incentives to move milk to the processing plants where it is most valuable. For decades, FMMOs encouraged overproduction of cheap non-fat dry milk powder. When fluid milk sales were high, they subsidized milk powder returns. With fluid sales declining, per federal order rules, cheese makers are left to subsidize powder through revenue pooling, and they of course declined to do so in 2020. Good intentions to create a system with uniform prices has resulted in a distorted system that is now coming unglued, to the detriment of dairy families whose income depends – at least in part – on the value of a blend of fluid milk, milk powder, and butter.

The government has provided risk management tools, including the Dairy Margin Coverage (DMC) program and the Dairy Revenue Protection (DRP) insurance. We use DRP along with futures and options to lock in floor prices for our milk. Last year we suffered substantial hedging losses as we tried to navigate markets that were pushed around by the pandemic and subsequent government interventions. Hedging losses are an unavoidable cost of risk management. Even though we incurred a loss on our hedging, we were able to offset the loss because our milk check climbed with the Class III price. Our neighbors and family who receive a blended milk price were extremely disadvantaged. Last summer, while we cashed some of our largest milk checks ever dairies in Michigan and Indiana were forced to sell their milk at the lowest prices since the historic dairy downturn of 2009.

The DRP and DMC have reduced the cost for producers to hedge against volatility and poor margins. But our pricing system must be improved to allow all producers to manage their commodity market risk. If dairy producers like my neighbors in Iowa and my relatives in Michigan can't anticipate what class of milk will participate in the FMMO pool, they won't know whether their milk checks will be based on the cheese price or the butter and powder price and they cannot hedge effectively. This happened on my sister's dairy, where I was raised in Michigan. Just like my dairy they hedged based on the cheese price and incurred a loss, however their milk check took a dive along with the class IV markets, so their loss was compounded. Byzantine FMMO rules make it hard to predict how her farm's milk revenue will correlate with the main milk price benchmarks on the commodity exchange. After this experience they are only willing to hedge a small portion of their milk and are much more exposed to market volatility. The combination of unpredictable FMMO pooling and ad-hoc government bailouts creates a moral hazard which further discourages risk management.

I appreciate that the DRP and traditional risk management tools are based on free markets. We should be careful to offer the same market-based freedoms to processors, who invest immense sums in our industry and also face commodity risks. We can modernize federal order regulations to provide consistent and predictable benefits to pooling milk and incentivize processors to react more quickly to shifts in market demand by redirecting milk to plants that produce the most valuable dairy products.

Milk pricing formulas currently prioritize fluid milk, which does not reflect the fundamental shift in market share to an export-driven market. For decades, fluid consumption has continually decreased. This decline coupled with depooling does not leave enough milk in the pool to provide premiums. In fact, dairy producers have frequently seen deductions on their milk check in the last year. Updating the order design to provide consistent benefits to all manufacturers would over time lead to a shift in plant capacity and product mix towards more value-added processing, which would reduce the disparities between our pay price and those of our disadvantaged competitors. In addition, changing the timing of the Class I pricing calculation to be nearer to the other classes of milk could reduce the incentives for manufacturers to de-pool.

The current federal order system is necessary and provides a safeguard against the market power of large milk buyers. But the system should be modernized to stimulate financial transparency and promote competition and innovation as opposed to consolidation among both processors and producers. Making milk checks more transparent would benefit dairy producers in two ways. Dairyman would better understand their earnings and might be able to make changes to farm management practices or co-op policies to avoid future deductions. Promoting competition between processors will give dairy families a better milk price and incentivize the development of new products and markets. Competition is good for everyone!

Every day, dairy producers must compete with one another for land, labor, livestock, and feed. The wide variance in mailbox prices caused by current pricing formulas creates a sense of helplessness among producers. While competition is good, it is unfortunate that federal policies create an uneven playing field. When some producers receive as much as $9 less for their milk than their peers, even the best operator would not be able to compete in the long run.

As a child my dreams for the future did not include owning and operating a dairy. Now that I have had the opportunity, I cannot imagine raising my kids in any other environment. They get to learn firsthand the value of hard work, where our food comes from, and how to care for the land and animals that God has asked us to steward. I am currently raising one equine enthusiast, one future vet, and one future dairyman; it is important to me that we design a system that gives them the best chance to accomplish their dreams.

Thank you again to Chairwoman Gillibrand, ranking member Hyde-Smith, and the rest of the committee for your time. It has been an honor to be here.

Written Statement of Mr. Mike Ferguson, Owner

Ferguson Dairy Farm

Tate County, Mississippi

To the Committee on Agriculture, Nutrition, and Forestry Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security of the United States Senate

"Milk Pricing: Areas for Improvement and Reform"

September 15, 2021

2707 Country Club Road
Senatobia, MS 38668

Chair Gillibrand, Ranking Member Hyde-Smith, and members of the subcommittee, thank you for the opportunity to testify before you today. My name is Mike Ferguson and I have operated a Holstein milking herd of 150 head in eastern Tate County, Mississippi for 45 years.

As a dairy farmer, I have served the industry in a variety of capacities. I am a Board Member of a variety of organizations that seek to support all producers, including the Southeast Dairy Farmers Association and the Dairy Cooperative Marketing Association. I have been a member of the Mississippi Farm Bureau Federation since 1985 and have served as President of the Tate County Farm Bureau for the last 15 years. Notably for purposes of today's hearing, I have chaired the Mississippi Farm Bureau's Dairy Advisory Committee for the last eight years.

The dairy industry in Mississippi currently consists of about 60 family farms. We are considered a milk deficit state, where we don't produce as much milk as our state consumes, so milk must come to us from other states. That has not always been the case, though. Although right now dairy isn't the state's top agricultural commodity, it's vital to the state's economy and food security net. Each of our approximately 7,000 dairy cows provide an average of 1,831 gallons of milk per year. These cows live on multi-generational family farms with an average of about 125 lactating cows per herd.

Mississippi is steadily and rapidly losing dairy farms. Over the past five years of extremely low milk prices, producers have struggled to put food on their own families' tables while providing it for the rest of us. We have lost approximately 28 dairies over this time, from 86 in 2016 to 60 now, a 30% decrease. These farms employ milking staff, nutritionists, veterinarians, and more. They support local businesses as well as state and national enterprises. Many of our 60 family farms in the state will not be here in a few years if things don't change for them. But those who are still here are part of our backbone and build their lives on hard work, integrity, and selflessness. Without them, negative changes will be felt from a local to a national level.

Dairy farmers are resilient though, and we get up every day to produce a valued product for the consumer. I would like to focus my testimony today on areas of improvement that Congress could review to make an impact to reverse this continued trend of the loss of dairy farms in the Southeast.

<u>Considerations for Adjustments to the Class 1 Mover:</u>

Most of our milk in the Southeast is considered for the Class I market. Class I milk is product generated for the fluid milk market. Cheese is the primary driver of Class III milking pricing, while Class IV pricing is driven by the price of nonfat dry milk powder. Butter is used to price the butterfat in each Class price of milk.

In recent years the use of risk management tools such as futures and options contracts or forward contracts have steadily increased. The Chicago Mercantile Exchange offers futures contracts for Class III and Class IV milk, but has never offered a contract for Class I. One reason was the basis risk associated with the previous milk pricing formula and the switching nature of the higher-of. The Dairy Forward Pricing Program allows farmers to voluntarily enter into forward price contracts with handlers for pooled milk used for Class II, III, or IV purposes under the Federal

Milk Marketing Orders. This program does not allow for the voluntary forward pricing of milk used to producer Class I milk products.

In order to accommodate industry requests to manage Class I milk price risk, Dairy industry organizations reached a compromise solution that would modify the Class I milk pricing formula in the farm bill. This compromise was in lieu of allowing voluntary forward contracting of Class I milk between a farmer and beverage milk processors or consumers under the Dairy Forward Pricing Program.

Congress subsequently modified how Class I milk prices were calculated in the last farm bill to dairy farmers. Under these new provisions, Class I milk is calculated based off the average of advanced Class III and Class IV prices, plus an adjusting factor, which defines the Class I Mover. Previously, Class I milk was priced based on the higher of Class III or Class IV, considered the "higher of" method.

During the initial onset of the COVID-19 pandemic, the traditional pricing mechanisms of Class I milk were skewed tremendously due to the unprecedented purchases of cheese by the federal government that sent Class III prices significantly higher than Class I and created a vast disparity in the true value of Class I milk.

While dairy farmers were no doubt grateful for the needed relief through the purchase of cheese products during the pandemic, the way it was done had significant unintended consequences that no one could have seen coming. While dairy farmers are eager to do everything possible to help people consume our products, it should have been done in a balanced way to minimize price disruptions.

Again, dairy purchases focused so heavily on cheese that Class III milk prices skyrocketed, which while beneficial for some producers, caused many others including me as a Class I producer a great deal of pain as traditional marketing conditions were upended. According to the American Farm Bureau, around the country the revenue shortfall due to the Class I milk price change was in excess of $740 million dollars compared to the former 'higher of' method of calculating the Class I mover. Across the three Southeastern federal orders, where I farm, the economic impact was more than $150 million in foregone revenue on the milk we pooled on the federal order.

So while Class III prices rose and that milk was in turn de-pooled in many cases, our producers whose Class I milk must always remain in the pool saw a lower blend price. Class I milk must always remain pooled, helping all producers get the benefit of its higher price in the blend price much of the time, but with traditional relationships upended, many farmers suffered last year.

As you know, milk pricing issues are challenging and complex across regional lines. It's important that we reform the Class I mover to make sure last year's conditions aren't repeated.

<u>Options for reform include but are not limited to:</u>

- Congress should consider immediately going back to the 'higher-of' until the dairy industry can proceed to a national rulemaking process through USDA's Dairy Programs to consider alternative Class I milk pricing rules. Under this more transparent process, stakeholders can provide evidence and testimony in support of or in opposition to proposed changes in milk pricing and pooling rules. While this may upend existing risk management efforts, a formal rulemaking process would ensure input can be received and reviewed by all stakeholders.

- A more frequent and thorough review of the national adjusting factor in the Class I mover calculation. The industry could consider this option and others through the transparent rulemaking process to better protect Class I producers like myself.

- A more frequent and thorough review of the national adjusting factor in the Class I mover calculation. Congress could advance that option to better protect Class I producers like myself.

Multiple Component Pricing for Federal Orders 5, 6, & 7:

In recent years, milk proteins have become a major value-added product in both domestic and international markets, driving the price of milk to record highs. However, across portions of the U.S., the milk pricing regulations are not designed to price all of the milk components that give milk its functional and economic value - specifically butterfat, protein, other solids and even somatic cell count.

Currently, the milk production areas of the country are divided into 11 federal marketing order regions. The Southeastern Regions, or orders 5, 6 and 7, include the Southeast, Appalachian and Florida orders and covers the geographic region from Louisiana, Arkansas and southern Missouri east, and portions of Kentucky and Virginia south. In these areas, as well as in Arizona, milk is not priced based on all the components in the milk – rather milk is priced on skim and fat alone, ignoring the value added of protein in the milk.

In the Southeast, the rising value of milk proteins combined with the region's alternative milk pricing scheme is believed to have contributed to challenges related to milk procurement. For example, the seasonally-deficit Southeastern milkshed is adjacent to marketing areas the price milk based on components. Thus, high component milk often moves out of the deficit southeast to manufacturing areas where higher prices are paid for the components in the milk. Lower component milk is then shipped into the order to fluid milk plants where the components are not fully priced. The milk trucks literally pass each other on the highway moving milk out of and into the orders. This is a disorderly movement of milk.

In light of these realities there has been a renewed interest in the southeast U.S. to consider abandoning the existing milk pricing system (skim fat) in favor of adopting multiple component pricing. Multiple component pricing is a very equitable idea. It's based on the concept that the regulated price of milk received at the farm level should reflect the functional and economic value of the milk.

Simplifying the terms of trade among milk buyers and sellers by placing value on the unique product attributes of a dairy farmer's milk helps to drive milk to its highest value and best use. This could facilitate more orderly marketing conditions and would create economic incentives for farmers to increase component productivity.

It is likely that milk proteins will continue to be a major nutritional and economic value-added dairy product in both domestic and international markets. Implementing a more uniform pricing scheme across large portions of the U.S. will help to improve component productivity and drive milk to its highest valued and best use.

Importantly, for farms like mine in the Southeast, component pricing could improve the price for the milk we receive and it could facilitate innovation and investment in the Southeastern dairy industry.

This too can be addressed through a rule making process, but I urge the subcommittee to carefully consider this issue in your conversations.

In closing, thank you for the opportunity to testify before you today. I look forward to working with you to reform milk pricing for the betterment of all producers and I stand ready to answer any questions that you may have.

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

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

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

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

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

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

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

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

It is critically important that we recognize the intersections in milk pricing and how a change in one area can impact a change in another. While I deeply and personally understand the urgency to resolve our challenges, thorough analysis of these intersections, considering all perspectives, is essential in guaranteeing reform success. Changes should be

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made through the formal rulemaking process to ensure that a comprehensive approach is taken. The formal hearing process allows for producer, processor and consumer voices and perspectives to be heard and considered.

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

Agri-Mark's Footprint

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

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

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

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

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

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

Dairy producer environment

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

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complex, encompassing the impacts that global trade has on our markets, labor pressures at all levels of the supply chain and changes in consumer appetites.

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

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

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

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

Impact of pandemic on the dairy sector

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

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

While grocery shelves were bare, the market was flooded with milk due to the overnight loss of food service. Nearly half of the dairy industry's demand vanished temporarily, causing record amounts of milk dumping

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and requiring processors and distributors to make significant, immediate and costly adjustments to their operations. Milk prices plummeted. The U.S. average all-milk price went from $17.90 in March to $14.40 in April – the highest single month decline since the price recording began in 1980. In May, the price dropped further, reaching $13.70, the lowest price since 2010. There was a moment when we feared half our membership could be lost within months. It was a very frightening time.

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

Federal Orders

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

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

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

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

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

Occasionally market conditions result in Class III prices spiking rapidly, which causes the Class III prices to exceed that of Class I prices and therefore blend prices. When this occurs, as it did in 2020 with the Food Box program implementation,

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the result was that after farmers were paid on a Class III component basis, more money was paid out than was available in the pool. To make the pool whole, the overpayment is balanced by the PPD. Simply put, when Class III prices exceed blend prices, PPDs are negative.

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

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

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

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

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

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

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

Summary

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

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

Catherine H. de Ronde

Testimony of Robert L. Wills
Dairy Subcommittee of the U.S. Senate Agriculture Committee
September 15, 2021

Introduction

Thirty-two years ago, I bought Cedar Grove Cheese. Ten years ago, I started Clock Shadow Creamery, an innovative, urban cheese factory. One of my colleagues said that I have the perspective of a seasoned dairy processor. However, I have always viewed our role as supporting the producers who supply milk to our factory as well as the health and safety of our consumers. I am confident that the average price paid to our patrons has been among the highest in the country.

Forty-seven years ago, I was on the staff of the Joint Economic Committee. Chairman Wright Patman directed me to the Library of Congress to find his statement at a hearing on the Glass-Steagall Banking Act of 1933. Afterward, he sent me a memo praising me for providing exactly what he wanted, with no additional fluff. The Congressman's note of appreciation for brevity is one of my most valued mementos.

Unfortunately, the subject of today's hearing is much tougher to condense:

> Administered milk pricing, established by Congress, functions opposite to its intent. Market orders cause higher dairy prices for consumers and lower milk prices for farmers. The system responds slowly and inadequately to changes in costs and demand shocks. The complexities of market orders create opportunities for anti-competitive behavior and promote consolidation among suppliers.
>
> Today, the dairy industry faces unprecedented challenges. We face increased international competition. We face rising costs and uncertainty from climate change. And, we face disruptive technologies that could replace much of the dairy industry. To serve our customers and farmers, we must be efficient and reduce our environmental footprint. Administered pricing does not and cannot set dairy product prices fairly or efficiently. The survival of the dairy industry may depend on eliminating the rigidities of the market order system as soon as possible.

An entrenched network of institutions and experts thrive on their specialized access and esoteric knowledge about milk marketing. They create controversies, including arguments about the appropriate number and boundaries of market orders; the size of make allowances; the number of product classifications; pooling requirements; negative producer price differentials; or whether the Class I mover should be based on an average or higher of the prices in other product Classes. All of these controversies are distractions from the main point. Administered pricing is inherently inflexible and inefficient. Other competing products are not subject to similar intervention.

The dairy industry has operated under market orders for about 80 years. During that time, the numbers of farmers and milk buyers has crashed, but the variety, quality and quantity of dairy products has improved. We have gotten by in spite of market orders that cause excessive shipping, distort the mix of products and discourage innovation.

Over the last year, milk was dumped while shelves were empty and people went hungry. That pandemic dumping was well-publicized, but it is not unusual for the market orders to pay farmers to dump milk. Wasting milk is disrespectful to the cows, to the farmers who raise, feed and milk them and to the hungry people who could use the milk. This is a sign of a decrepit and indefensible system.

Here is another example of the absurdity of milk pricing. Yesterday, I learned the market order price for milk that I bought from farmers on August 1st. That is over 40 days after I have sold some of the cheese. In three days, my patrons will learn what they were paid for August milk. They have already made production decisions for September, and probably, October without knowing whether they will make money.

There are many other huge topics in dairy pricing. Dairy farmers, like cheese plants, have been through a tough period. Government programs to purchase and distribute dairy products were enthusiastically embraced throughout the industry. Direct payments to farmers efficiently provided relief. Many of my farmers would welcome supply management to raise milk prices, presumably offset by subsidies to needy consumers. I might prefer a solution that does not make it hard for dairy products to compete, but I welcome efforts to assist small dairy farmers. The margin protection programs from the last Farm Bill had the opposite effect, lowering prices by encouraging additional production. These are tough issues, but I am going to limit my discussion here to market orders.

A Vestige of the 1930s

The first justification for administered pricing in the early years was nutrition. During the Great Depression, Congress wanted to assure that fluid milk was available to people, especially children, throughout the country. At the time, most milk was sold locally. Milk production was concentrated in Wisconsin, New York and a few other states. The Federal Milk Market Order (FMMO) was designed to encourage farmers to produce milk in underserved regions and to prioritize milk to bottling rather than other dairy products.

Today, bulk fluid milk moves easily around the country. And, there is plenty of milk for the relatively small fluid market. Nonetheless, the market order system continues to encourage dairy farming in hot and arid parts of the country where feed has to be supplied from hundreds of miles away.

A secondary purpose for establishing administered pricing was to protect small farmers from exploitation by “large” processors. By establishing minimum prices, all covered farmers, especially farmers in regions with few potential buyers, would be protected from exploitation.

Today, most milk is produced on farms that make more milk than my cheese plant uses. The total number of farms in Wisconsin fell from 140,000 to under 7000 while the total volume of milk increased. Most milk comes from farms that sell tanker loads of milk, often with part of the water removed, and the farmers are able to sell to buyers hundreds of miles aware. Farmers are savvy and sophisticated business owners, often belonging to marketing groups, who are not exceptionally needy of government protection.

Participation in marketing orders is not mandatory, except for bottling plants. Why would manufacturers of other dairy products voluntarily make their milk available to the market order?

To encourage participation, the Federal Milk Market Order system, created "classified pricing". To simplify, a premium price for bottled milk creates a premium pool that is distributed to manufacturers of yogurt, cheese, or butter and milk powder. When participating manufacturers receive their share of the pool, they must pay higher prices to their farmers. Companies that don't participate have less money and would lose farms.

Flimflam

I asked Senator Gillibrand's staff to omit the part of my biography when I worked for a carnival, Royal American Shows. But, actually, I find that I learned many valuable lessons in that job. Let me illustrate the market order system with a kind of shell game.

I have 4 cups (Class I, II, III, and IV) and under each one I place 5 beans, representing milk from 20 identical farms. For simplicity, think of a bean as a gallon of milk produced by one farmer and initially earning that farmer $1/gallon.

The Market Administrator says, "We can raise the price of fluid milk if we reduce the volume of milk going to bottling". So, three beans move to the other cups. The price of milk in Cup I jumps from $1 to $2.50 because of scarcity. But, because there is now more milk in Class II, III and IV, the price those manufacturers get for that milk goes down to $.83. Those farmers aren't happy and the companies they sell to don't like the game. Only the two farmers supplying the first cup are happy. So, the Market Administrator takes the extra $3 from the first cup and gives part to each of the farmers supplying the other three cups. Now, every farmer gets the same $1 price for their gallon of milk.

In this case, the price received by the farmers is the same as if the Market Administrator had not intervened and milk in each cup sold for $1. But milk in the first cup only uses 10 percent of the total milk supply and each of the other cups get 30% of the milk rather than each getting 25%.

From the perspective of the 18 farmers in the last three cups, the market order is wonderful because it has given them $.17 of "extra" money compared to the $.83 that came from sales of products made from their milk.

A Tax on Vulnerable Consumers

So, if our cup game represented the real world, why would policy favor the administered pricing system over the competitive market?

Some economists have sold this system to farmers and policy makers as a way to take advantage of market segmentation. The theory is that the total returns for milk can be increased if some segment, in this case fluid milk, has inelastic demand. By reducing the amount of milk in that segment and raising its price, while redirecting the milk to other segments, the total amount of money spent by consumers for dairy products would increase. In other words, the order would take advantage of consumers who continue to buy fluid milk when its price is increased (or at least do not reduce purchases proportionately). We add more extra money to Cup I than we take away from the other three.

Of course, this strategy runs directly counter to the initial purpose of the market order, namely to support nutrition by making milk available to consumers, especially children. The product we ostensibly want to encourage people to consume has an artificially higher price. The premium on fluid milk also causes higher costs for school lunches and government food programs.

What's more, those economists were wrong in expecting consumers would keep buying more expensive milk. Over time, milk has faced more and more competition in the beverage sector. Non-dairy substitutes, enhanced water, juice, coffee, and alcoholic beverages have taken market from fluid milk. Bottled milk's share of total milk and of total beverage sales has been in continuous decline for decades. Because consumers buy less fluid milk, the premium pool to be shared with other manufacturers keeps shrinking.

Back to our cups. Suppose consumers will pay only $2 for fluid milk in Cup I rather than $2.50. The pool is $2.10 and after distribution each of the 20 farmers gets $.95. Farmers supplying cups II through IV still see that they are receiving $.12 more than they would have gotten from their own market.

That is what this old, former-carnie would call a flimflam. The farmers cannot see that without the intervention of the market order, they would have received a dollar. "Everyone is a winner!"

The illusion of winning even when actually losing explains some of the continuing loyalty to the market order system. Manufacturers of Class II, III and IV products, and the farmers who supply them, see the gifts from Class I. But, they cannot discern that the total pot is smaller.

There is no evidence that current Class I and II premiums are optimal and provide enhanced value to farmers. If the premiums are set too high, then a larger drop in milk sales results in lower revenue. If the premiums are set too low, then value lost in other classes could be greater than the premiums. Not only is it unclear that there is a Cinderella value of premiums that helps farmers, but if there is such a value, there is no evidence that the government is able to choose it.

Complications

Part of the reason it is hard to see whether or not market orders are beneficial is because they are immensely complicated. Market orders distort the mix of products. Market orders create numerous inefficiencies including needlessly transporting milk. Eleven different regional market orders have different prices and rules. Large companies move milk to take advantage of order differences. But the overall point is that the regulations and order shopping reduce the size of the pool and the total money available to farmers.

Bottling plants often compete for contracts, such as schools, that required advanced pricing. To enable bottlers to set an advanced price, market orders base premiums for Class I on the prices of cheese and butter and powder in an earlier period. This creates mismatched timing in the formulas. When commodity prices are going up, the pool of premiums on fluid milk can be small or non-existent. The lags are partly responsible for the controversial negative Producer Price Differentials (PPDs). In those periods, other dairy processors and their milk suppliers are subsidizing bottlers.

Small or negative PPDs occur most frequently in areas where the percentage of milk used in bottling is small. When the premiums are no longer an incentive to participate, milk associated with those other products is pulled from the administered pricing system. Various market orders have created rules to prevent or discourage companies from “depooling” milk. Sometimes milk dumping occurs when suppliers are forced to stay in an order that that has no capacity to use the milk.

During the past year and a half, most milk has not been pooled in market orders because the cost of participation is greater than the value. My factory decided two years ago to leave the administered pricing system. Many other independent dairy companies have made the same choice. The draw from FMMA Order 30 over the past several years has averaged negative, meaning our milk producers were being taxed to support farmers supplying other plants.

The decision to depool also results from technical flaws in the pricing system. Unlike cooperatives, proprietary plants are required to pay each farmer a minimum price based on components of their milk. The formula for calculating that price recognizes that plants have a cost of transforming milk into cheese; The current “make allowance” was established based on studies conducted about 12 years ago. Most of the information came from the old California market order and was based on the costs in large volume plants using powder in addition to fluid milk. These allowances were below the costs faced by actual plants in most of the country even when they were adopted.

Since the “make allowances” were calculated, costs have increased significantly. Just over the past year, we have faced increases in costs of cultures, enzymes, salt, plastic, cleaning supplies and cardboard averaging over 5 percent. Labor costs alone for our plant have increased about 4 cents per pound of cheese. Inflationary pressures have increased “post-pandemic”. If we were to pay every farmer the required market order minimum prices every month, we would not be able to pay our employees. It takes more than a just a positive pool draw to justify participating in the market order because the formula does not account for real processing costs. Continuing inflation will force more proprietary companies to withdraw.

To illustrate, think about another carnival scenario. I have an ice cream stand and but I have to buy the ice cream mix from the carnival owner. When I charge 25 cents a cone, the owner charges me 30 cents. If I raise my price for a cone to 30 cents, she charges me 35 cents for the mix. The obvious solution is to sell cotton candy.

Similarly, cheese producers are under increased pressure to sell varieties of cheese other than Cheddar so they are able to make money. If they make cheddar and pass along cost increases the formula will increase the price of milk. Basing the Class III formula on Cheddar prices discourages production of that variety. The price of that biggest selling variety, Mozzarella, is not included in the weekly survey of prices used in FMMO price formulas.

Among the rules governing market order participation is a requirement that plants demonstrate their ability to supply milk to a bottling plant. These shipping requirements have varied widely across order regions and over time.

The most significant change in access has resulted from consolidation among bottlers. At one time, we had several bottling plants that we could call on to buy the qualifying loads and they in turn would call me if they needed more milk. Many bottling plants closed or were purchased by larger conglomerates and cooperatives. Other bottling plants entered into full supply agreements with larger milk suppliers. Today, national concentration in milk bottling is high and, regionally, sellers of bulk fluid milk may have few options to qualify their milk for access to pool draws. Besides limiting market order access, the requirements for qualifying shipments contribute to unnecessary trucking and greenhouse gas emissions.

In place of our direct relationships with bottlers, we were offered the option of joining a "super pool" (Central Milk Producers Cooperative) administered by the cooperatives who also set the regional market order rules. In a very complicated and obscure process, the administrators would decide when and how much milk we had to ship and which bottling plants it would go to. By joining the super pool, we lost control of timing and predictability of shipments as well as pricing of the milk. Some years we would have no milk shipments, but would be allowed to continue to participate in the market order based on shipments by other entities in the super pool. We had higher management expenses and made less money than we did when we could supply bottlers directly. This contributed to our decision to exit the market order.

To summarize, I suspect that voluntary participation in market orders by proprietary processors will continue to decline. Only fluid milk handlers are required to participate. The various market order formulae are rigid and cannot adjust quickly to changes in costs or technology or demand. Current make allowances are woefully inadequate. Only companies or cooperatives who can manipulate that system will remain and any benefit to their farmers will shrink. People who make their living by understanding the orders will engage in increasingly desperate efforts to tweak the system to encourage participation. Likely, they will solicit various forms of Congressional intervention to keep the system afloat. These efforts are not primarily based on the ability to help farmers.

New Challenges

The dairy industry has survived, and in some cases thrived, through 80 some years of market regulation and administered pricing. Why is it urgent to reconsider the system today?

One reason is the need to address every policy that contributes to climate change. Removing authority for milk market orders would prevent excess trucking of milk to take advantage of differences across the orders or trucking as a requirement of participation.

Another challenge prodding change comes from companies investing in ways to produce milk that do not involve animals. Plant-based milk substitutes, such as soy and almond drinks, provide an important alternative for people who are unable to consume dairy. But, these products have, so far, been unable to replicate milk for nutrition, taste and functional properties. To date, the sales of these products have grown, but only a small amount of consumption has seemed to replace milk.

In coming years, fermentation-based technologies may pose a bigger threat to milk. New startups are attracting large investments from large, international investors. Some of the bio-food companies are using genes transplanted in microbes to produce specific dairy proteins in large tanks. Those proteins are then isolated and have the same characteristics as milk-derived components like casein and whey protein. Several ice cream companies are using these to produce non-animal ice cream.

The potential for large-scale production of whey protein, presents a serious threat to the dairy industry. For every pound of cheese, about 9 pounds of whey is left from the milk. During the last couple decades, selling whey powder has created significant revenue for cheese plants, especially those that have their own drying capacity. Whey protein goes into many products as diverse as energy and body building drinks, and pancakes. The new industry may be able to gather feedstock for their bio-processors and produce an isolated “whey” protein cheaper than dairy plants can cool, pasteurize, remove lactose and fat, and dry whey. Without a whey market, cheese plant’s disposal would be environmentally challenging and expensive for dairy processors.

In the latest technological development, some scientists have replicated bovine (and maybe human) mammary cells, grown them in mass and learned how to make them lactate. Unlike the earlier technology, this technique claims to be able to produce the entire matrix of “milk”, including fat, sugar, vitamins, minerals and other nutrients, that is indistinguishable from cows’ milk.

The success of these alternative methods of producing “dairy” products hinges of economic cost and consumer acceptance as much as science. To compete, the dairy industry will need to reduce its environmental impact and lower its costs as much as possible. It will need to convince consumers that cows are not as creepy as vats full of genetically-altered cells.

None of the challengers to milk sales, including international competitors and processors of vegetable analogs or biotech replacements, are saddled with the burden of the milk market orders. The dairy industry needs to quit squabbling over esoterica of milk marketing and keep its eye on the prize, our customers. The government should step out and let dairy compete. That is the best hope for our farmers.

Testimony of Christopher A. Wolf, Ph.D.
before the United States Senate Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety & Security
Hearing "Milk Pricing: Areas for Improvement and Reform"

September 15, 2021

Christopher A. Wolf
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Chairwoman Gillibrand, Ranking Member Hyde-Smith, and Members of the Committee, thank you for inviting me to be part of this hearing. I currently serve as the E.V. Baker Professor of Agricultural Economics in the Charles H. Dyson School of Applied Economics and Management at Cornell University where I have been a faculty member since 2019. Prior to 2019, I was on faculty at Michigan State University for about 22 years. My research and extension program focuses on dairy markets and policy as well as dairy farm business management where I provide education and information for decision-making and analysis for dairy industry stakeholders and policymakers.

The US dairy industry is a key agricultural sector producing more than 223 billion pounds of milk generating farm cash receipts exceeding $40 billion in 2020. Major trends that have influenced the US dairy market include changing consumption patterns, the rise of international trade as a major outlet for US dairy products, and consolidation at all levels of the supply chain. With respect to consumption, beverage milk per capita consumption has trended downward on a per capita basis since the 1970's with the rate of decline increasing since 2010. Interestingly, the fluid milk consumption decline largely halted during the pandemic but recently has reverted to long-run trend declines with more people eating away from home. In contrast to beverage consumption, per capita cheese consumption has grown consistently for decades. Butter consumption recently reversed long-term per capita declines to grow as well. Total US dairy consumption per capita has largely increased consistently as dairy is considered a fundamental part of a balanced and healthy diet. At the same time, milk production growth has outstripped domestic dairy consumption in recent years. The rise of exports has coincided with the increase in milk production and the declining influence of the former Dairy Price Support Program. Since 2005, dairy exports have grown from accounting for about five percent of milk production to currently accounting for more than 16 percent. Export markets assist in balancing the production of butterfat and milk proteins. Because export markets are the marginal value of many US dairy products, there are farm milk price implications of the burgeoning dairy exports including the influence of international supply and demand as well as the political impact of trade.

The issues that motivate this hearing relate to farm milk pricing under the Federal Milk Marketing Orders. Federal Milk Marketing Orders (FMMOs) are one of the determinants of farm milk price. FMMOs have their origins in the Great Depression Era and have been reformed or updated periodically to reflect market and industry evolution. The primary functions of FMMOs include providing an adequate supply of consumer milk and promote orderly milk marketing. The most recent major FMMO reform was put in place in 2000. In recent years, there has been an underlying dissatisfaction with the farm milk price and this, along with the length of time since the last major revision of FMMOs, has focused attention on this set of policies. Part of the dissatisfaction with FMMO performance has to do with the shrinking influence of fluid milk revenues to be shared across the pool. The declining share of fluid milk is a consequence of both increasing consumption of cheese, butter and other dairy products as well as declining per capita consumption of fluid milk. When the FMMOs were created, the majority of milk in those Orders was used in fluid products. Shrinking relative share of Class I (fluid consumption) milk means that there is less money in the pool. This change, along with international markets, technology and other economic factors argues for a re-examination of FMMOs and their role.

It is often said that transparency is key for farm milk pricing. I would argue that FMMOs are, in fact, transparent in that they operate in a very deliberate and clearly defined manner. However, they are complicated and incomprehensible for many and, as such, are often misunderstood and the subject of blame. The process of moving from wholesale product prices to the FMMO pool price for a given Order and month farm prices involves many steps. The resulting farm price includes market and cooperative factors as well as farm specific aspects including quality and hauling. Understanding the drivers of farm milk price must consider all of these aspects. 2020 was a challenging year for many in the dairy industry. In particular, dairy farm financial outcomes were a function of (1) where and how farm milk was marketed including regional and cooperative issues; (2) farm risk management program participation—particularly what a given farm operation had in place entering 2020; and (3) government payments and programs for which the farm qualified and signed up including CFAP and PPP.

The dairy farm financial stress of 2020 was the result of farm milk price volatility and uncertainty. FMMO's in multiple component orders pay farms based on component value plus a value termed the Producer Price Differential (PPD) that reflects the pool revenue in excess of components valued using wholesale prices. In 2020, record low negative PPDs caused consternation and frustration among dairy farmers. These PPDs were not just abnormal in magnitude, they were unpredictable and greatly contributed to farm milk price volatility. Recent research shows that the large declines in PPDs were driven by a whole host of factors including: trends in utilization driven by consumption changes, trends in milk component production, the change in the Class I skim milk pricing mover from the higher of Class III and IV to the average, and depooling of milk by Class III processors. The impact of each of these factors varied both across Federal Milk Marketing Order and over time. The regional FMMO impacts depended on utilization, processing capacity, and other market factors. On average across FMMOs, the largest impact in contributing to negative PPDs in 2020 was due to depooling of milk while another significant impact was the Class I pricing change that went into effect in May 2019 (Bozic and Wolf, 2021). Both of these factors were exacerbated by the historically wide divergence in Class III and IV prices in 2020 due to the change in consumption from split between food at and away from home as well as government purchases of dairy products.

With this background in mind, I briefly address each of the issues raised by the Committee.

1. *Class I milk pricing* methods were changed in the 2018 Farm Bill and implemented in 2019 to make the Class I skim milk mover be the average of the Class III and IV advanced skim milk price plus a fixed $0.74/cwt rather than the higher of those advanced prices. The $0.74/cwt add on was chosen to be "revenue neutral" to farm milk price in the sense that it was set equal to the long-term difference between the average and higher of Class III and IV prices. One implication of this rule change is that when the difference between the Class III and IV advanced skim milk prices exceeds $1.48/cwt the resulting Class I price built from this new formula is less than it would have been using the higher of the two prices. The pandemic in 2020 resulted in a wide and prolonged divergence in Class III and IV prices due to many factors including the increased production of butter to balance milk supplies that were formerly

consumed in restaurants as well as government purchases of cheese for donation (Wolf, Novakovic and Stephenson, 2021). This large divergence in butter and cheese prices, and resulting Class III and IV milk prices, meant that Class I milk prices were lower than they would have been under the former pricing rule. Many solutions have been discussed by the dairy industry including reverting to the old, higher of rule, as well as snubbing the difference to avoid effects of large price divergences. This is one potential pricing change that would almost universally help farm milk prices.

2. *Pooling/depooling rules* are unique to each FMMO depending on the utilization and qualification factors in that region. Class I fluid processors, with a few exceptions for very small processors, must participate in the Federal Milk Marketing Order while other processors can participate if they qualify. A primary motivation for FMMOs is to ensure availability of fluid milk for consumers. Thus, fluid processors do not have the choice of whether to participate. This also means that Class II, III and IV processors might choose not to participate (pool milk). One reason for non-fluid processors to participate in Federal Orders is to share in the revenues from Class I sales that allows a higher payment to farms from which they purchase milk. When Class III is the highest price, cheese processors would be paying into the FMMO revenue pool rather than drawing from it for that month. Cheese processors can choose to withdraw any or all milk from the pool for that month and pay farmers with that money instead of sending it to the FMMO. There is the potential that, after withdrawing, the cheese processor can pay their farmers more than they would have received from the FMMO while still paying less than the Class III price. In this case, the farmers selling milk to the cheese processor that depooled may receive a higher price, but farmers selling to other processors who are participating in the pool that month receive a lower price. One reason that processors may hesitate to withdraw from the pool is that in order to pool milk in future months, they must requalify that milk. The length of time it takes to requalify milk varies by FMMO. For example, the Northeast FMMO has rules that include many months to requalify while some other FMMOs are less stringent. The precise qualification and pooling rules have evolved across FMMOs based on utilization and specific market aspects.

3. *Make allowances* are the amount of the wholesale dairy product price that accounts for the manufacturing cost when calculating the component farm value of milk. All else equal, increasing the make allowance for a product means that the amount of the wholesale dairy product price that is passed on to farmers is less. Make allowances have been updated one time since the FMMO Reform in 2000 and that was more than a dozen years ago. It is not difficult to see that many costs have changed since that reform including energy and labor. The entire supply chain—from farmers to processors—must be healthy for a prosperous dairy industry. If make allowances are inadequate, then processors with higher costs will either be driven out or make up the difference elsewhere. One option might be to depool allowing more flexibility in pay price. Another potential impact of the make allowance is the incentive to invest in new

manufacturing capacity. If make allowances are not sufficient to provide a return to invested capital, then they may act as an impediment to investment. It is time to reconsider the costs of manufacturing dairy products used in FMMOs.

4. *The Farmers to Families Food Box Program* was implemented in 2020 to both assist needy families through product donation and backstop dairy product demand. The government intervened through the "Farmers to Families Food Box Program" which particularly increased domestic disappearance of American-style cheese and fluid milk and resulted in record high cheese prices as supply chain struggled to adjust to a shift in demand between cheese types. The onset of the Farmers to Families Food Box program coincided with record negative PPDs. In terms of the impact of the Farmers to Families Food Box Program the lesson is that the industry and markets function better without surprises which drive market volatility.

5. *The FMMO Hearing Process*. The Federal Milk Marketing Order Hearing Process is one area that is subject to "formal rulemaking." Formal agency Rulemaking is time consuming but collects input from all interested parties and must weigh the interests of all involved parties (consumers as well as producers, cooperatives and processors). While it is clear that many in the dairy industry are unhappy with the length of time it takes to go through the formal rulemaking process, it is not clear that there are areas which can be sped up or what would be the potential consequences. Further, there are examples of changes made to FMMOs outside of this formal process that resulted in unintended consequences that required attention later. The strength of the current process is that it balances all interests and is less likely to result in adverse consequences.

Given the age of the FMMO system, length of time since the last major reform, and changes in the market from both the production and consumption side, it is likely time to re-examine many aspects of FMMOs including many issues that motivate this hearing. If we were to start over with US dairy policy, it seems unlikely we would arrive at the current system. However, there are legitimate reasons for making each of the previous policy revisions and choices. The current set of markets and institutions has evolved around the FMMO system as it is currently constituted and the ripple effects of reforms should be carefully considered. There may be lessons that could be found in the systems found in other countries. Any reform should balance the interests of all involved parties including equity as well as economic efficiency.

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DOCUMENTS SUBMITTED FOR THE RECORD

SEPTEMBER 15, 2021

Remarks of Senator Patrick Leahy
Hearing: 'Milk Pricing: Areas for Improvement and Reform'
U.S. Senate Committee on Agriculture
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
September 15, 2021

Thank you, Senator Gillibrand, for holding this important and timely hearing. Every Vermonter knows: dairy never takes a day off—and so, in particular, I thank our witnesses for being here.

Ms. de Ronde, I welcome your appearance here today. Agri-Mark is an indispensable member of Vermont's dairy community. I could always count on your predecessor, the late Bob Wellington, to provide sound counsel. I know you will as well.

Dairy is a bedrock industry in Vermont and the Northeast, anchoring our rural economies for generations. But years of price volatility, consolidation, and rising costs have squeezed small and mid-sized farms. Vermont has been losing farms at a devastating rate – even before the pandemic. Since 2012, we have lost more than 40 percent of our dairies. That is 400 families no longer milking cows, with impacts seen across entire communities and our working landscape.

Our farmers continue to struggle with an economic climate that is beyond their control. Last month, I welcomed Secretary Vilsack to Vermont. Together, we announced $350 million in assistance to dairy farmers who received lower prices due to market abnormalities caused by the pandemic.

To help make their businesses whole again, we must also look forward to solutions that improve their resilience, increase transparency, and address longstanding market inequities. I look forward to your perspectives about the lessons we have learned from this pandemic and how this Committee and USDA can improve dairy markets for farmers. Our rural economies depend on it.

Thank you, Senator Gillibrand, for holding this hearing, and to all the witnesses for being here. I need to attend a hearing in the Judiciary Committee, but I look forward to reviewing the testimony today, and submitting questions to the witnesses.

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Senate Committee on Agriculture, Nutrition, and Forestry
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
Milk Pricing: Areas for Improvement and Reform
September 15, 2021
Statement for the Record

Senator Charles Grassley

I wanted to thank Chair Gillibrand for holding this bipartisan hearing on a very important topic for Iowa dairy farmers, milk pricing.

Before I start the introduction of the witness from Iowa, I wanted to quickly mention the concerns I have on another topic for which this committee has not had hearing, the reckless tax and spending spree being teed up.

I'd like to echo the words of our colleague, Senator Manchin, who asked his fellow Democrats to hit the pause button on the $3.5 trillion spending bill.

The House Agriculture Committee recently approved a partisan spending package close to $100 billion. That's a level of agriculture spending similar to the 2018 Farm Bill, on which this committee devoted many hearings.

The Agriculture Committee and the Farm Bill are two areas where I can point to for Iowans and say that bipartisanship still exists in the Senate.

Unfortunately, the tradition of true bipartisanship in this committee is lacking in this area. This enormous tax and spending bill has been written with no input from Republicans and no input from stakeholders. I don't recall ever seeing such partisanship or reckless spending in this committee before.

When you consider the potential devastating tax increases on family farmers, Senator Manchin's counsel of "hitting the pause button" should be taken seriously.

Now, on to my introduction.

The dairy farmer with us from Iowa is Christina Zuiderveen.

She is a managing partner of three dairies: Black Soil Dairy in Granville, Iowa; Mt. Hope Dairy in Beresford, South Dakota; and Dakota Plains Dairy in Centerville, South Dakota.

On a day-to-day basis, Christina works in book-keeping and HR. Christina is on the board of the Iowa State Dairy Association. She is also a member of Edge Dairy Farmer Cooperative, located in the Upper Midwest, and serves on a regional milk pricing task force.

She has previously served on the Central Plains Dairy Expo board of directors. Christina attended Cornerstone University and received her degree in business marketing. She grew up on a dairy farm in California before her family took the operation east to Michigan. She now resides in Iowa with her husband, Nate, and their three children.

Christina, welcome to the Senate Agriculture Committee.

QUESTIONS AND ANSWERS

SEPTEMBER 15, 2021

U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
Milk Pricing: Areas for Improvement and Reform
September 15, 2021
Questions for the Record
Mr. Jim Davenport

Senator Reverend Raphael Warnock

1. Mr. Davenport, thank you for your testimony. In your written statement, you discuss how your farm has approximately 300 direct store delivery customers in the Hudson Valley and many additional customers in the New York City area. I am interested in learning more about how you tapped into this regional market and were able to bridge the rural-urban divide to access a larger customer base. I believe there could be similar opportunities for farmers in south Georgia to take advantage of growing markets in the Atlanta metro region.
   a. What barriers were present as you began to sell directly to stores in your local community and into the New York City metro area? How did you overcome those barriers?
   b. What actions could Congress take to better support farmers who are looking to take advantage of similar opportunities in local and regional markets?

Thank you Senator Warnock for your interest in how we have been able to tap into the regional markets and bridge the rural-urban divide. The Hudson Valley Fresh broke into the New York City metro New York market was to make available a top quality product to potential customers to taste, enjoy and want more. A big boost for us was getting our products to the chefs at the (CIA) Culinary Institute of America in Hyde Park, NY. Using our products in their cooking and baking classes sold the students on their quality and consistency. They have a new class of students every six weeks. Each of the chefs and bakers in training receive samples of a single serve white and a single serve chocolate milk. By the time they leave school and they think of top quality milk they think Hudson Valley Fresh!

I think once the farmer is making high quality the largest hurdle is finding a plant close by to process the perishable milk. We started off with a small plant that had their own brand and helped us out by bottling our farmers' milk under the Hudson Valley Fresh label. We ended up moving from there to a larger plant nearby and in time bought that plant from the older owners. Their sons have stayed on and managed the plant as Hudson Valley Fresh employees. These are barriers which really have nothing to do with regulatory issues. As I said in my testimony, the fluid milk processing business has consolidated to the point that small local plants are rare.

I would say that if farmers need to have a plant to process their milk, they should first try to find a plant that will exclusively process their milk and package the product in the farmer's labeled bottles. The next step would be for the farmers themselves to visit small supermarkets, coffeehouses, and the like. This will make their product available to customers more effectively. If the USDA has grants available for this type of venture, it would be most helpful. Hopefully, at this point the farmers will start to receive requests for their products and the brand grows. Now research for a Grant and/or a Guaranteed Loan could be considered to obtain their own plant. I believe that the Metro-Atlanta area has plenty of people who are looking for local and quality milk products and would pay a bit more for it. This allows the producer to receive a higher price for their milk.

Those involved in producing bountiful food supplies in upstate New York are shocked that there are "food deserts" in New York City! Therefore, anything that can be done to provide locally grown food to the city's population would be a win for all.

One thing that would help all United States school children would be a nutrition program that includes whole milk. The falsehood that dairy fat is "bad" has been debunked. Science has proven that whole milk is an important "one stop shop" for nutrients needed by growing children and young adults. As I stated in my testimony, with Senators Gillibrand and Marshall concurring, whole milk in school nutrition plans is the way to go. An observation I should make is that when I was a kid in school, everybody drank whole milk as part of their school lunches. It was not flavored, just tasty whole milk. In my small class of 130 students there were just a handful of students who were overweight. If dairy fat is deemed to be the culprit for overweight children, why has the proportion of overweight school children exploded over the past four to five decades.

2. Your testimony also notes that you supply all the dairy products used by the U.S. Military Academy at West Point. How did this relationship being, and how could Congress further incentivize relationships such as these to strengthen the connections between our farmers and U.S. military installations?

US Foods, a large food service company has the contract at West Point. Our reputation and high quality products had some fans among some of the Cadets. A West Point official lived near one of our member farms and loved the local aspect and of course the products themselves. When the Cadets asked why they couldn't have good milk like Hudson Valley Fresh, the official reached out to US Foods and they contacted us. The rest is history~
Milk Consumption at West Point, colleges, private and public schools has steadily risen since we have supplied them with Hudson Valley Fresh milk. Quality and taste buds rule!

The best way to enter into new alliances, be it U.S. military installations or schools, is for the producer to work directly with the food service provider for the individual food service program at that base or school. Also, it must be "proved" that their product will outsell the product currently used. I think that Armed Service Committees could hold up the success of providing local, high quality milk at West Point to base commanders around the Country. If they want the very best for their troops, try high quality dairy products. If the demand is there, food service providers should listen. It is very important that the milk be good. Farmer(s) must be willing to promote their products and share their stories to complete this goal.

Senator Warnock, I hope I have answered the questions to your satisfaction.

Senate Committee on Agriculture, Nutrition, and Forestry

Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security

Milk Pricing: Areas for Improvement and Reform

September 15, 2021

Questions for the Record

Ms. Christina Zuiderveen

Senator Charles Grassley

1. You've mentioned that you have family across the country that are engaged in dairy farming. Have you seen your family in different areas affected differently based on what Federal Milk Marketing Order they are in?

My relatives and I receive vastly different milk prices. The rules governing our respective Federal Milk Marketing Orders are similar. The differences arise because of the products for which our milk is used. The current milk pricing formula cannot make up for the wide pay variances between milk used for cheese and milk used for butter, whey, and powder. For this reason I believe the underlying formula should be changed to take into account the fundamental market shift that has taken place from a fluid-based market to an export driven market.

2. Farmers have several risk management tools available to them. Have the tools that USDA offered in the 2018 farm bill helped your farm mitigate the risk of recent volatility? If not, what tools have you implemented? Are there ways Congress can help improve your risk management abilities?

I appreciate that the risk management tools added in the 2018 farm bill are market based. My dairy uses the Dairy Revenue Program (DRP) which has been useful to us because my milk check is based solely on the Class III price. However, for dairies whose milk check is based on a blend of Class III and IV the unpredictability of which price the check will be based on make this program unreliable to them.

My farm also uses the Dairy Margin Coverage (DMC) program. The DMC consistently makes payments when national average dairy profit margins are poor. However, this program is clearly skewed to benefit small producers. It covers all annual milk production for dairies with 200 cows or fewer. On my dairy we use up our DMC coverage with just 22 days of milk production.

I do not think we need to add more risk management programs. The current offerings of DRP and DMC are adequate provided we update the milk pricing formulas to be fair and provide predictability.

Because the DRP is market based it will react to natural market swings. Each time we add non-market based government programs we risk unintended consequences that affect producers, processors, and even consumers.

3. Farmers today are very savvy, and in general have a very good handle on what is going on in the industry, but I have heard that when a farmer gets their milk check, it is convoluted and difficult to understand all the different calculations that make up their end price. Do you feel that the average farmer is able to completely comprehend their milk checks?

Dairy producers' milk checks clearly show their base milk price, along with deductions and bonuses. However, the reasons behind the premiums and discounts are unclear. It can be difficult to understand how processors or co-ops determine hauling deductions and quality bonuses. There are good reasons for the Producer Price Differential (PPD), but they are extremely complex, and the PPD can create huge swings in dairy producers' milk prices from month to month.

If dairy producers could more clearly interpret the reasons behind the premiums and deductions on their milk checks, we could make on-farm changes to improve our revenue. However, when it comes to PPD we have no way of predicting if this number will be positive or negative, because we can't anticipate which milk will be pooled in any given month.

Dairy producers typically have a great understanding of the cost to produce their milk and how inputs such as feed can affect their milk quality. Most producers follow the commodity milk price throughout the month, so they are understandably frustrated when the PPD causes their milk check to stray far from their expectations.

4. What do you do for risk management on your farm?

We use the Dairy Revenue Protection (DRP) program along with futures and options to lock in floor prices for our milk. We also take part in the Dairy Margin Coverage (DMC) program. However, it covers so little of our milk, that we do not count it as a risk management tool.

Senate Committee on Agriculture, Nutrition, and Forestry
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
Milk Pricing: Areas for Improvement and Reform
September 15, 2021
Questions for the Record
Mr. Robert Wills

Chairwoman Kirsten Gillibrand

1. Public policy plays a critical role in shaping farm gate prices, addressing anti-trust issues, and supporting a new generation of dairy farmers. In addition to the topics we have discussed today, could you all talk about key federal policy reforms that you think are needed to fundamentally address market concentration, consolidation, and farm loss in dairy?

Senator Gillibrand. Thank you very much for this question. I think it properly focuses on the core issues that can help dairy farmers. I greatly appreciate your efforts in this hearing to consider significant changes that could help our farmers get a fair price.

The key to economic fairness and innovation is competitive markets. In my career prior to becoming a cheese maker, my industrial organization research and teaching focused on market power. Large market shares and heavy advertising enable sellers to get higher prices from consumers. And concentration among purchasers resulted in lower prices to atomistic suppliers. At the time, most agriculture markets were used as examples of competitive markets. Today, dairy markets in many parts of the country have only a few large buyers. And, often those large buyers are encouraging consolidation of farming and leaving small farms without a market.

One source of concentration has been the merging of farmer cooperatives. These cooperatives benefit from some exemptions under the Capper Volstead antitrust act. Cooperatives also share special treatment within the Federal Milk Market Orders. They are able to vote on behalf of their members as a block to establish market order rules. Those rules often seem to be designed to support the organizations rather than individual farmers. For instance, the market orders do not require the cooperatives, who make the rules of the order, to pay farmers minimum prices. They do, however, have rules that force the competing proprietary plants to pay each farmer a minimum price regardless of their location, milk quality or size. This disparity enables cooperatives to purchase milk at a lower price and undercut their competitors, sometimes forcing them out of business. That anti-competitive tool has contributed to consolidation, concentration and farm loss.

Federal policy changes should address the anti-competitive behaviors and monopolistic practices of all market participants. It should require consistent treatment of all milk buyers regardless of whether they are nominally owned by independent or farmer investors. Farmers who invest their earnings in their own farms should not be disadvantaged over those whose earnings are retained by their cooperative. And proprietary companies who pay their farmers well and are innovative should compete on an even playing field. The goal should be for farmers to be courted by many potential buyers of their milk.

2. Organic milk is not interchangeable with conventional milk, yet the FMMOs assume all milk is the same. Should FMMOs be updated to recognize that various types of milk and milk alternatives in a time of increasing consumer choice and differentiated products - organic, grass-fed, A2, plant-based, etc?

Producers of organic, grass-fed, and A2 are all paid premiums that should earn them more than the FMMO minimums. I do not see any need to specify the size of the premiums that those producers should receive. The FMMO is not equipped to determination what those premiums should be or to adjust the premiums with rapidly changing market conditions. All of the farmers producing specialty milk are permitted to send to plants that participate in the FMMO on the same terms as other producers. The FMMO does nothing to encourage or discourage buyers of specialty milk from participating if it is advantageous for their producers.

On the other hand, plant based and bio-cultured dairy substitutes are unregulated. They are free to innovate and sell products that compete with dairy without the burden of FMMO regulations. While I advocate for removing the burden of the FMMO on dairy producers, I recognize that it may take some time to phase that out. In the meantime, a tax on plant-based and bio-cultured products could help level the playing field and protect dairy farmers. Most importantly, laws should be in place and enforced that eliminate consumer confusion about whether products are dairy based or created through some other process.

3. The USDA FMMO regulated price structure assumes that the demand for fluid milk is relatively inelastic. Does this premise hold in today's market given the availability of conventional milk alternatives (e.g. value-added fluid milk, organic, grass-fed, A2, plant-based, etc.)?

There is strong evidence that fluid milk sales are being eroded by competition from non-dairy alternatives. Some strength in fluid milk products has resulted from sales of flavored varieties, packaging innovations, etc. However, this progress has not been sufficient to offset the higher prices caused by market orders and the impact of aggressive competition from non-dairy beverages. For many years, both the percent of milk going into fluid use and the per capita consumption of milk beverages has been falling. The premium on fluid milk imposed by the market orders has clearly contributed to the decline in sales of fluid milk.

I do not think there was ever very good evidence that the price premium on fluid milk imposed through the order system was an effective way to increase revenue to dairy farmers. But, the assumption that higher prices would not result in less fluid milk consumption is contradicted by the evidence.

4. How do mailbox milk prices change when milk is not pooled on the FMMOs (i.e. when milk is de-pooled)?

Average prices received by farmers do not have a clear correlation with whether milk is pooled or depooled. The FMMO is a redistribution scheme, not a creator of value.

The simplistic view would be that the companies who are depooling milk are doing so because they wish to pay their producers less than the pool minimum price. Actually, the milk is often depooled for two other reasons. First, because the pool minimum price in a particular period is too high for the value received by processors for the products they sell. Second, because the order requires redistribution to bottling plants from processors of other dairy products. That redistribution would take money away from the patrons supplying those plants. Participation in the redistribution through that pool does not have any necessary correlation with the average payment to dairy farmers.

Recently, very large percentages of milk in most regions of the country have not been pooled. This reflections the failure of the FMMO to accurately account for market conditions and its failure to consider the actual costs of converting milk into other products. Because cooperatives are not required to pay minimum prices to their farmer suppliers, even the milk that is pooled does not necessarily result in higher prices to farmers. Often, farmers who supply plants that depool are paid higher prices even when the fluid milk plants are receiving subsidies through the pool.

In the long run, the option of depooling milk may help some companies stay in business. Those companies could fail if they were required to pay more for milk than the value of the products they can make. If depooling keeps buyers in business and enables them to exist as viable competitors, then that will tend to increase mailbox prices in the long run. I am not aware of any study or evidence that indicates that mailbox prices would necessarily be higher in the short run or the long run if buyers were forced to pool all of the milk.

Senate Committee on Agriculture, Nutrition, and Forestry
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
Milk Pricing: Areas for Improvement and Reform
September 15, 2021
Questions for the Record
Dr. Christopher Wolf

Senator Kirsten Gillibrand

1. Dr. Wolf, over the past decades dairy farmers across the country were encouraged to produce more milk and become more efficient in order to make their operations financially sustainable, and dairy farmers responded. According to a USDA Economic Research Service report, milk production increased 40% between 1980 and 2017, but this increased production hasn't saved the dairy industry. According to that same report, during a similar period, between 1978 and 2017 the U.S. lost 83% of its licensed dairy herds. Can you talk about the scale and trajectory of the dairy crisis over the past decades, the scale of dairy farm loss, and how this has impacted consolidation within the sector?

Response:

Dairy farms as a whole are unique in the sense that they are generally a full-time occupation for at least the primary operator. In this sense, when they exit they fundamentally change the economic activity for that family as well as the businesses they support in the local community. Because there is no formal supply management program in the US, the way in which excess supply is dealt with is that some farms exit—either voluntarily or involuntarily. Economies of size exist in dairy farming because of the relatively high amount of fixed costs related to facilities and other aspects that can be spread across more units of production with herd growth. Consolidation in farm numbers and herd size has been occurring since the end of World War II. In the past couple of decades, when the Dairy Price Support Program has not been interfering with market prices, the farm milk price has tended to have boom or bust years. During bust years, dairy farm exits accelerate. The period from 2015-2019 was particularly difficult for many dairy farms as milk prices were frequently low relative to costs such as feed. At the same time, consolidation at the retail level has incentivized consolidation up the supply chain to meet contract needs and minimize transactions costs.

2. Dr. Wolf, the power and voice of the small farmer has diminished as mega dairies and large consolidated operations change the landscape of the dairy industry. Where do small dairy farmers go for representation in the consolidating power structure of the dairy industry? They pay the mandatory checkoff and own the cooperatives, but where do they come to the table in a transparent discussion of the policies, pricing mechanisms, labeling, and promotion programs that affect their profitability and risk management at the farm level?

Response:

Cooperatives and other farm organizations are the major avenues that dairy farmers of all size have to provide input and feedback to policies and programs. Dairy cooperatives are organized as "one farm member, one vote." It is certainly the case that dairy cooperatives have been struggling with the structural imperative in recent decades as they have members managing a wide range of herd sizes. Because of the divergence in size and the business models that accompany herd size, it is increasingly challenging for dairy cooperatives to reflect all aspects in business decisions. Further, the politics related to regional aspects including utilization, labor, environmental and other issues make it difficult for the dairy farm industry as a whole to coalesce around policy preferences.

3. Public policy plays a critical role in shaping farm gate prices, addressing anti-trust issues, and supporting a new generation of dairy farmers. In addition to the topics we have discussed today, could you all talk about key federal policy reforms that you think are needed to fundamentally address market concentration, consolidation, and farm loss in dairy?

Response:

The large amount of capital required to establish or purchase a farm today is a hurdle that policy might address on a larger scale than existing programs. Farms provide amenity value and ecosystem services. These aspects might be the foundation of policy reforms in the future which could benefit farms of all sizes. In particular, forthcoming environmental regulations will likely be extremely challenging to farm financial performance. The boom or bust cycle that has characterized the industry in recent years means that a policy such as a tax deferred savings account might be useful for farms to manage volatile income streams. Current tax policies sometimes encourage sub-optimal farm investments to deal with boom years whereas the ability to shift funds to poor milk price years would be preferable.

4. Organic milk is not interchangeable with conventional milk, yet the FMMOs assume all milk is the same. Should FMMOs be updated to recognize that various types of milk and milk alternatives in a time of increasing consumer choice and differentiated products - organic, grass-fed, A2, plant-based, etc?

Response:

Federal Milk Marketing Orders primary function is assuring a ready supply of fluid milk for beverage consumption. Virtually all fluid processors are required to be part of the FMMO while other classes of manufactured dairy products can choose whether to pool milk on FMMOs. There are trade-offs between how many uses of milk are formally recognized and performance of FMMOs. Many have been advocating to move in the other direction and have two classes of milk, fluid and all manufactured products, so that class definitions do not artificially limit milk movement between product uses.

FMMOs pool the minimum class values of milk and share those revenues across all qualifying and participating milk. The examples cited above are aimed at differentiating products to achieve slope on the demand curve and thereby enhance revenue. These enhanced revenues can be achieved on top of FMMO minimums and those producers are unlikely to want to share broadly not the least of which because the products are more expensive to produce. The inability of over-order premium agreements to maintain premiums in recent years relates to surplus milk supplies and exacerbates the lack of revenues pooled across producers and cooperatives providing market services.

The question does raise interesting aspects of the current FMMO system that would be potentially fruitful areas to examine. It would be of use to consider the different ways in which farmers market and are compensated for milk around the world today and what might be adapted to the US. One way to begin this discussion is to appoint a study group to report back to policy-makers such as the Senate Agricultural Committee.

5. The USDA FMMO regulated price structure assumes that the demand for fluid milk is relatively inelastic. Does this premise hold in today's market given the availability of conventional milk alternatives (e.g. value-added fluid milk, organic, grass-fed, A2, plant-based, etc.)?

Response:

The price discrimination and pooling aspects of FMMOs result in beverage milk consumers paying a higher price while manufactured product consumers realize a lower price, ceteris paribus. The higher beverage milk price is shared with farmers depending on the milk pooled in an Order. An inelastic demand for fluid milk is essential for increasing total pool revenues and thus average pool price paid to farmers. While there are reasons to consider whether the elasticity of demand for fluid milk has become more elastic over time, such as the increased about of substitute products, academic studies consistently find that fluid milk has an inelastic demand.

However, this aspect is deserving of further study as substitute products and flexitarian households become more common. If fluid milk demand is significantly more elastic, the logic behind the current FMMO structure requires re-examination.

6. How do mailbox milk prices change when milk is not pooled on the FMMOs (i.e. when milk is de-pooled)?

Response:

When milk is de-pooled, the revenues from that milk are not part of the FMMO pool that are distributed for that time period. While Class I (fluid) processors—with a few minor exceptions—must be part of the FMMO pool, processors of other Class uses may choose to not participate. Generally, we would expect that Class I is the highest milk price most of the time meaning fluid processors are paying into the pool and other processors are taking a draw from the pool with which they can pay farmers for their milk. If Class III, milk for cheese and whey, is the highest price for a given month or set of months, cheese processors may choose to not pool milk because they would be paying into the pool rather than collecting a draw. When the higher price milk is de-pooled, the revenue available and average price paid out to farmers remaining in the pool is lower. The processor that depools may choose to share the higher prices with their farmer members but farmers not selling milk to that processor will be worse off. Because FMMOs are primarily about fluid/beverage milk, the qualification and pooling rules revolve around the ability and willingness to serve Class I markets. The qualification and re-pooling standards vary across FMMOs.

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Senate Committee on Agriculture, Nutrition, and Forestry
Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security
Milk Pricing: Areas for Improvement and Reform
September 15, 2021
Questions for the Record
Ms. Catherine de Ronde

Senator Kirsten Gillibrand

1. Ms. de Ronde, the Dairy Mandatory Price Reporting program that was established in 2010 required USDA to release dairy product sales information and establish an electronic mandatory sales reporting system. This program has been critical in providing accurate and reliable pricing data in FMMO formulas. What are some ways we could improve this program to enhance price discovery even further?

   The Dairy Mandatory Price Reporting program plays an essential role in data collection used by the Federal Milk Marketing Orders. Price and volume data for butter, non-fat dry milk, cheddar and dry whey are collected. To ensure the survey continues to reflect the marketplace, the program should be revisited periodically. With price discovery as the goal, it would be beneficial to the industry's reform efforts for USDA to report on what is driving the seemingly low percentages of U.S. production reported in the survey. There are certainly viable reasons why this may be the case (certain products that are not considered general commodities should not be in there), however it would be helpful to hear from USDA on these exact reasons.

2. Public policy plays a critical role in shaping farm gate prices, addressing anti-trust issues, and supporting a new generation of dairy farmers. In addition to the topics we have discussed today, could you all talk about key federal policy reforms that you think are needed to fundamentally address market concentration, consolidation, and farm loss in dairy?

   As discussed, Federal Order reform is critically important to ensure that our system is working for all dairy participants, most notably our dairy farmers, which is why we are so grateful for the opportunity to participate in this hearing. These reforms must include a change to the Class I mover to rectify the unintended consequences of the 2019 change, to ensure dairy farmers are not negatively impacted from this change in future volatile market periods.

   In addition to Federal Order reform, there are a multitude of federal policies that greatly benefit the dairy industry and are worth retaining and building upon. As we approach the next Farm Bill, we must ensure that dairy producers continue to have well-functioning safety net programs and risk management tools to maintain financial stability. Continued conservation funding will help the industry meet its 2050 Net Zero Initiative, build upon dairy farmer's long tenure of being stewards of our lands, and meet the demands of today's consumers. We must continue to fund federal nutrition programs and remove barriers limiting the type of allowable dairy products (whole milk or 2% milk) to make sustainable and nutritious dairy products available to all. The 2018 Farm Bill's Farm and Ranch Stress Assistance

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Network, a USDA program aimed at connecting producers to stress assistance and support programs aligns with efforts our cooperative has undertaken in recent years to help farmers manage these extremely difficult times. We urge Congress to continue to provide robust funding for this program. Lastly, exports play an increasing role in balancing our marketplace. U.S. dairy farmers are the best in the world, making tremendous strides in efficiencies and sustainability that are in demand by international consumers. We must ensure that we have the trade policies in place to ensure that today's hurdles do not become long-term barriers in our ability to be the leader in the global marketplace.

3. Organic milk is not interchangeable with conventional milk, yet the FMMOs assume all milk is the same. Should FMMOs be updated to recognize that various types of milk and milk alternatives in a time of increasing consumer choice and differentiated products - organic, grass-fed, A2, plant-based, etc?

   While organic and conventional milk are marketed separately, they are both fluid products. The Federal Order system was designed to regulate fluid milk and the expense of getting fluid milk from the countryside to consumers in dense populations. While changes to our FMMO system are necessary, there is still value to the original goals of the FMMO to ensure a steady supply of fluid milk.

4. The USDA FMMO regulated price structure assumes that the demand for fluid milk is relatively inelastic. Does this premise hold in today's market given the availability of conventional milk alternatives (e.g. value-added fluid milk, organic, grass-fed, A2, plant-based, etc.)?

   According to the latest USDA report to Congress on the promotion programs, the own-price elasticity of demand for fluid milk was -0.08 which is still relatively inelastic.

5. How do mailbox milk prices change when milk is not pooled on the FMMOs (i.e. when milk is de-pooled)?

   Milk is incentivized to be de-pooled when the non-Class I price for milk exceeds the average value (i.e. Blend price) of the other classes of milk. When milk is de-pooled, producers in the pool receive a lower uniform price for their milk. The de-pooling handler receives a higher return for de-pooled milk than if that milk would have stayed in the pool. When the handler de-pooling is a cooperative, that higher return is passed on to their members. Non-cooperative handlers have the option to pass these returns to their supplying dairy producers.