Senate Agriculture Committee Field Hearing
MSU Kellogg Center, East Lansing, Mich.
April 9, 2011
Mr. Ken Nobis

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Michigan Milk Producers Association

Senator Stabenow and Senator Roberts, thank you for holding this first official field hearing on the upcoming reauthorization of our nation's Farm Bill. I appreciate the opportunity to provide testimony regarding dairy policy and the 2012 Farm Bill. My name is Ken Nobis and I am a dairy farmer from St. Johns, Michigan and I also serve as President of Michigan Milk Producers Association, a milk marketing cooperative owned by approximately 2,100 dairy farmers in Michigan, Indiana, Ohio and Wisconsin. Dairy products are Michigan's Number one agriculture commodity contributing nearly $6 billion to Michigan's economy. Michigan is the nation's 8th largest dairy state and is growing in both milk production and processing capacity. In the past ten years, milk production in Michigan has increased by over 40 percent.

The dairy industry in the United States has always been a dynamic one, marked by continuous structural changes in the numbers and sizes of dairy farms, the productivity of dairy cows, the location of milk production, the distances that milk and dairy products are transported and many other factors that make it a unique segment of American agriculture. However, in other ways, those structural characteristics that are particularly germane to dairy *policy* have remained remarkably constant for the past several decades. For example, until relatively recently, the U.S. dairy industry has been characterized by the following: Almost all U.S. milk production has been marketed within the United States, albeit in a steadily-changing mix of many different dairy products. In addition, U.S. dairy farmers have had the domestic market almost entirely to themselves; imports have been low and fairly stable due to WTO-consistent import restrictions that are a long-standing component

of U.S. dairy policy. World trade in dairy products has been relatively small and conducted at prices below those prevailing in the U.S. domestic market, because that trade had been dominated by subsidized exports from Europe and other high-cost milk producing countries as well as exports from a few countries with pasture-based milk production systems that could compete with those subsidies on a cost basis. Feed grain prices, which determine a dairy farmer's largest cost component, were relatively low and, apart from occasional short-term spikes induced by drought or disease, were very stable.

Our current dairy policy was designed for the industry I have just described, and it has been very appropriate for that industry and has served it well. However, over just the past half decade or so, this industry has changed radically, to the point where our current dairy policy cannot serve the needs of dairy farmers to any significant degree, and in some ways is now actually harmful to them. Major changes in world supply and demand conditions, together with the country's need to seek alternative energy sources, have made grain prices much more volatile and driven them to levels that put dairy farmers' cost of production persistently far above the support levels fixed under our current policies. Growing world demand for animal proteins, and dairy products in particular, has boosted world dairy market prices and rapidly turned the U.S. dairy industry into a major commercial exporter. In fact, we are now the world's third largest exporter and the fastest growing, as U.S. dairy exports have shot up from the equivalent of less than 6 percent of U.S. milk production in 2003 to almost 13 percent in 2010. Volatility in the prices that U.S. dairy farmers receive for their milk has increased dramatically during this period, a direct result of these recent structural changes.

The starkest example of this is the U.S. dairy industry crisis of 2009, which was caused when the United States lost substantial market share of the growing world markets

during late 2008, and the resulting loss of commercial sales volume built up as large unsold inventories in the domestic market. U.S. dairy exports had reached the equivalent of 11 percent of U.S. domestic milk production in 2008. Through the first half of that year, import demand around the world was strong, world prices for dairy products were at all-time high levels and all major dairy exporting countries were experiencing strong exports. Then however, resistance to the high prices built up, and import buyers, with full product pipelines, held off further purchases when prices showed signs of weakening. World prices then plummeted, taking U.S. prices down with them. However, the U.S.'s major export competitors, with greater experience in world markets and more flexible marketing mechanisms, were better able to maintain their export volumes when world demand soon picked up again at the lower prices in 2009. The European Union quickly reactivated its sizeable export subsidy program, while New Zealand's Fonterra company, the exclusive exporter of most of New Zealand's dairy production, and with a share of about 40 percent of the key internationally-traded dairy products, had the pricing flexibility to boost its exports during this period. The U.S., by contrast, was not used to marketing dairy products against competitors who held major market shares and who possessed long-established relationships with import customers. U.S. exports dropped and did not recover fully for almost two years.

During the last half of 2008, total U.S. dairy exports plunged by the equivalent of almost 10 billion pounds of milk, or over five percent of total U.S. milk production. Our industry has never experienced a sales loss of this magnitude in the domestic market. This loss resulted in a buildup of commercial inventories of cheese and government-owned inventories of nonfat dry milk that kept prices depressed for an extended period and generated an unprecedented loss of U.S. dairy farmer equity, even with the removal of

about a quarter of a million dairy cows through the industry-funded Cooperatives Working Together (CWT) program in 2009.

Building domestic product inventories during periods of low milk prices made sense in the previous dairy industry structure, when price support levels were closer to milk production costs. But it makes no sense at a time when, by one measure based on USDA cost data, the cost of producing a hundred pounds of milk in the United States averaged about $17.30 during 2008-2010, while the Dairy Product Price Support Program (DPPSP) only supports the price of all milk produced at about $10.90. The Price Support Program disadvantages dairy farmers in other ways in today's dairy industry. It encourages nonfat dry milk and other basic dairy products to be produced to government standards, which have been developed to ensure long storability. However, these standards do not reflect the products that dairy importers want to buy in today's global dairy marketplace where individual end-user specifications rule the day. Furthermore, in today's increasingly price-interconnected global dairy marketplace, the Price Support Program has increasingly become a price support program for the world, even benefitting some dairy farmers in other countries more than it does U.S. dairy farmers. For example, the price of nonfat dry milk, which is closely correlated in the U.S. and world markets and has been most heavily influenced by the Price Support Program in recent years, plays a much greater role in determining the price of milk received by farmers in New Zealand than the price received by U.S. dairy farmers. And anything that interferes with maintaining and growing U.S. dairy exports, as the Price Support Program now does, has a serious negative impact on U.S. dairy farmers.

Every time the U.S. loses export market share, and relations with overseas customers are disrupted, as in 2008 and 2009, it reinforces the U.S. reputation as an

unreliable export supplier -- that is, a supplier who is there when prices are high, but absent when they are low. Regaining overseas business and rebuilding export shares is a slow process, and prices U.S. dairy exporters receive in the world market are often discounted in the process. This process has cost U.S. dairy farmers billions of dollars in revenue over the past couple of years.

Another key component of current U.S. dairy policy is the Milk Income Loss Contract (MILC) program, which makes direct payments to dairy farmers when milk prices fall below a fixed target level. As with the Price Support Program, the recent increase in feed costs has eroded the effectiveness of the MILC-fixed price target, even with the addition of a feed cost adjuster to the formula in the 2008 farm bill. Furthermore, the milk volume limitation, or cap, on the amount of payments to an individual dairy farmer under the MILC program, creates substantial inequities among dairy farmers, based on the scale of their operations. The MILC payment cap has also resulted in the steady erosion of the total volume of U.S. milk production that is protected by the program, as the size of the average dairy farm has steadily grown. With less than half of the U.S. milk supply currently eligible to receive MILC payments, it cannot be considered a very effective safety net program for dairy producers across the country.

With this as background, it is clear that current U.S. dairy policy is no longer serving the needs of U.S. dairy farmers and is in need of a major overhaul. Over the last two years, dairy producers and cooperative representatives have been meeting through the National Milk Producers Federation Strategic Planning Task Force to address the challenges of today's dairy industry. The Task Force developed the Foundation for the Future, a comprehensive package of dairy policy programs that will bring much needed change to many aspects of current dairy programs. The Foundation for the Future is designed to help

reduce price volatility and protect producer income by focusing on producer margins rather than on milk price alone. This needed shift in policy is essential to improving dairy producer equity and stabilizing dairy markets. The four components of the Foundation for the Future program include: replacing existing federal dairy support programs, introducing a new margin protection program to protect producer equity, implementing a market stabilization program to address market imbalances and reforming milk pricing regulations set by the Federal Milk Marketing Order system. This multi-faceted approach dramatically improves the traditional approach to dairy policy and provides for a more economically viable and secure future for dairy producers.