Testimony of Gerald Heatwole

House Agriculture Committee Hearing

July 17, 2006

Staunton, Virginia

I'm Gerald Heatwole, a dairy farmer from the Shenandoah Valley of Virginia. My wife Anita and I, along with our son Monte, operate two dairy farms, milking a total of 475 cows and producing over 11.5 million pounds of milk in the last 12 months. We farm approximately 1400 acres. We have been in the dairy business for 33 years. I serve on the Southeast Area Council of Dairy Farmers of America, Inc. (DFA). DFA is a national milk-marketing cooperative based in Kansas City, Missouri with dairy farmer member owners in 48 states.

I represent my neighbors by serving as chairman of the board for the Shenandoah Valley Electric Cooperative, and I serve on the Ag Advisory board of First Bank and Trust Company, a regional bank. Additionally, I serve on the Board of Directors for the Virginia American Dairy Association, which is a milk-promotion agency. I am also a partner in two farm equipment dealerships in my area.

I appreciate the opportunity to testify at this hearing today.

While organizations that I belong to have not officially established positions for all of the 2007 Farm Bill issues, I would like to share my thoughts on some of the major themes that will define the dairy sections of the bill.

Before I speak to those issues, I would like to thank Chairman Goodlatte and Ranking Member Peterson for their help to all DFA dairy farmer member owners in the passage of S2120 – the producer handler legislation. We worked on this issue for more than three years, and it would not have been passed without your support.

I have a written testimony that is more detailed on all of the points that I will touch on today. I'd like to submit that document for the committee's reference. I will spend most

of my time today discussing some Federal Order issues that my fellow Southeastern dairy farm families are most concerned about.

1) We support continuation of the Federal Milk Marketing Order program. Marketing Orders are important to us as they undergird all of our marketing and pricing efforts all over the country. Orders assure dairy farmers a minimum price, assure that all competing milk buyers pay the same minimum price, assure that all dairy farmers share equitably in the returns of the marketplace and assure that the terms of trade are uniform throughout the Order's marketing area. These objectives remain very important ones in the dairy marketplace. Moreover, despite the claims that they are outdated and not relevant, the primary reasons for the institution of Marketing Orders still exist: There are many more buyers than sellers, and the average-sized milk buyer is much larger than all but the very largest dairy farms; milk production is still very seasonal an milk demand has a weekly and seasonal purchase pattern that requires substantial costs to balance producer supplies with buyer demand. Individual dairymen, and even large groups of dairy farmers, continue to need the stability of Orders to deal with these marketing challenges.

Milk markets are priced based on national supply-demand situations, which are largely influenced by areas of the country that have a surplus of milk. The national situation does not necessarily reflect the needs of the Class I market; therefore, we feel the need for a separate pricing system that allows all Class I milk to be priced differently than current. Because of this situation we are suggesting a policy that would establish a floor for the Class I mover at no lower than $13.00 per hundredweight. This solution would be market based and have no additional government cost.

We are, however, becoming very frustrated in our attempts to get the Order system to recognize the increasing cost of transporting milk to the market. Our concern is the very real impact that fuel costs play in the transportation equation, and the manner in which these costs are not equitably shared among all producers in the Federal Order system. The transportation cost issues have become increasingly important because

of: (1) transportation cost increases, especially for diesel fuel and (2) "flattening" of the Class I price surface in the process of implementation of "Order Reform" by Congressional directive in January 2000.

The dairy farmers who supply the Southeastern markets work together through the Southern Marketing Agency (SMA) to most efficiently deliver milk to the market. We have asked USDA to look into recovering transportation costs at an Order Hearing that I testified at. Specifically, we asked that the existing transportation credit system be adequately funded and a fuel cost adjustor be added to the Order's pricing provisions. The current system has been in place since the late 1990's and helps to share the cost of bringing in milk supplies from outside of the Southeast into the market. In June of 2005 the Southeast had to source 58% of its sales from dairy farmers located outside the Southeast. Outside purchases in August 2005 were double those needed in August 2000. The over-the-road hauling cost in 1997 when the credit was implemented was $1.75 per mile, and by 2005 had increased to $2.35. I am sure members of Congress are familiar with diesel fuel cost changes, so I don't need to provide any information about them. In 1997 this particular Federal Order program offset 95% or more of the transport cost. In 2005 the reimbursement rate covered less than 40%. The volatility of fuel costs changes is nearly impossible for dairy farmers to pass through in a timely manner.

We also asked USDA to institute an additional transportation credit system that would help move milk produced inside the southeast to customers within the southeast. This new program would function much like the existing program and would be run by the Order system to insure fairness and accuracy. It would require all farms to pay the cost of getting milk to the closest plant to them, and then have the market share in the cost of any additional miles.

Even though the Southeast is a deficit market, there are several pockets of heavy milk production. I live in one of those. But not all the milk produced here in the Shenandoah Valley can be sold here – there are not enough local plants to process the milk nor are there enough local consumers. Milk from my farm regularly goes into North and South

Carolina supplying markets there, but most days it is hauled 485 miles to Charleston. The cost of this transport falls to producers like me whose milk is pooled in the SMA pool. This transportation expense just adds to the other high production costs, resulting in part from climatic conditions detrimental to milk production and high on-farm energy costs and contributes to the loss of dairy farms in the Southeast which cannot remain profitable. Every farm in the Order, through the blend price, shares the revenues from these sales, but not all share in the cost to get it there! Believe me, this is an important issue to Shenandoah Valley dairy farmers and to all the other dairy farmers in the Southeast.

I'd also like to point out that our Hearing proposals were supported by all of the major cooperatives in the Southeast who represent over 80% of the production and all of our customers. I have attached a summary of the key points that we presented to the Secretary of Agriculture in the Hearing for your review.

We seem unable to get the USDA staff to realize the dilemma we face. They seem to understand the problems that energy costs play in manufacturing dairy products and have asked for proposals to address make allowances. But when we try to get the same rationale to apply to transport costs, we are struggling to get them to respond.

It is not for a lack of trying that we can't seem to communicate with USDA. We have made several proposals to deal with these issues in various Orders around the country with the following results:

- The Central Order (Order 32) - Transportation credit proposals were rejected in a recommended decision and a final decision is pending.
- The Mideast Order (Order 33) - Transportation credit proposals were rejected in a recommended decision and a final decision is pending.
- The Appalachian Order (Order 5) - Hearing held in January, no decision to date.
- The Southeast Order (Order 7) - Hearing held in January, no decision to date.

- **The Northeast Order (Order 1) - No action has been taken upon a formal request for a hearing submitted February 3, 2006.**

If USDA fails to help dairy farmers in this dilemma, we may need legislation to address this issue.

Also, while we are frustrated with the slow pace of change through Federal Order hearings, we are hopeful that proposed reforms initiated by USDA will speed up the hearing process and make it easier to get a Decision.

2) **DFA members are participating with all the other members of the National Milk Producers Federation's Dairy Producer Conclaves to develop a consensus position on Farm Bill issues. We will keep you and your staffs informed of our efforts and seek your counsel on issues as we discuss them.**

3) **Because we do not think there will be radical shifts in policy direction as a result of the 2007 Farm Bill, we support the view that an extension will work well for most of the nation's dairy farm families.**

4) **We feel the next Farm Bill should maintain some form of an economic safety net for dairy farmers. Safety nets prevent prices from falling so low that businesses become unviable. Because dairy products are such an excellent source of nutrition for our nation, and due to the high fixed cost of becoming a dairy farmer and the fact that milk production assets have limited use in any other agriculture enterprise, past Congresses have maintained safety net provisions for the dairy industry. We hope this Congress will continue these policies.**

The most important safety net provision we have is the dairy price support program. We favor continued operation of the dairy price support program at a targeted $9.90 U.S. average manufactured milk price. We would oppose granting the Secretary of Agriculture any discretion, which would reorient its intended purpose away from

supporting income to farmers just to result in minimizing government costs – and we may need Congress to instruct the Secretary of Agriculture of this fact in some official manner. Under President Bush's proposed Ag budget, the Secretary of Agriculture would be allowed to adjust buying prices for products made from milk (cheese, butter, and nonfat dry milk) so as to reduce the cost to the CCC for products purchased. This could allow for a reduction in the targeted support price of $9.90 as specified in present legislation.

Additionally, I would request that the Commodity Credit Corporation (CCC) take action and adjust the support program purchase price levels for cheese, butter and nonfat dry milk to reflect the significant additional costs manufacturers face when selling products to the CCC. The current CCC purchase prices for dairy products do not reflect any costs beyond those incurred for commercial sales. As a result, market prices for individual products have, from time to time, fallen below support levels, allowing the price of milk used to produce them to fall below the statutory support level for milk of $9.90 per hundredweight at average test. NMPF has provided information to CCC but thus far CCC has been unwilling to take action. The result is that manufacturers will sell to buyers other than CCC at prices below the support level in order to gain a higher net value than the support purchase price due to the cost of selling to the CCC.

Right now CCC is buying some quantity of NFDM – doing what safety nets are supposed to do. The last time milk prices fell to safety net levels was in 2000 when the average Class III price for the year was $9.74 (below the support price of $9.80 for milk of 3.5% butterfat test). The 10-year average Class III price is $12.62. Because the price support program is in place and working, we hope to avoid a price crash like in 2000 – but if it wasn't around and prices did fall to that level, our two dairies would face a loss in income of $331,200 on an average year's production. That would be hard for our business to withstand. We are very interested in stable policies that help to keep reasonable prices and a safety net that maintains some level of viability for a dairy farm family.

In general, the guidelines for a safety net program should be that it:

- **does not discriminate between farmers of differing sizes,**
- **does not discriminate between farmers in different regions of the country and**
- **is not high enough to encourage additional milk production.**

The government's safety net policy should only operate at a point where a collapse of producer prices could force too many producers out of business, and our nation's milk-producing infrastructure would be damaged.

5) **A majority, but unfortunately not all of the nation's dairy farmers, have funded and are operating a self-help program – Cooperatives Working Together (CWT). Dairy farmers voluntarily pay 10 cents per hundredweight on all milk produced in order to structure the size of the nation's dairy-cow herd and more closely tailor milk supply to demand. Additionally, the program works to assist exports of dairy products in an attempt to market and promote domestically produced dairy products to the world.**

   However, the CWT program is not intended to replace federal farm programs and can never do so, because there will always be those who choose to take advantage of the program's benefits but never pay their share. Even after three years of successful implementation, there are still over 25% of the country's dairy farms that choose not to pay in. In spite of our success, we still need Congress's help in providing policy support to our industry.

6) **Dairy Farmers also see policies outside of the Farm Bill impacting their future such as:**

   Environmental Policies

   The implementation of conservation and environmental practices on our farm is extremely important to our operation. We have developed a close working relationship with our county NRCS and FSA offices in developing conservation programs for our home farm, Cub Run Dairy. We have a nutrient management

plan to help control runoff of phosphorus and nitrogen discharges and have also implemented a conservation plan for our entire operation.

We applied and received funding through the EQIP programs to offset the cost for these practices. Without the cost sharing mechanism it would have been difficult to fund all of these activities, and we are very appreciative that they exist. However, based on our experience, the process needs review.

The methods used by the Department of Environmental Quality (DEQ) took a long time to process. Their estimates of the cost of our particular project were understated – primarily because their construction cost formulas were based on data that was several years old and not reflective of current material and labor costs. This weakness in the process can easily be corrected.

The end result is a sizable gap – in my case over one hundred thousand dollars between the program reimbursement and the actual cost – far below the program's goal. Instead of the stated goal of 75% reimbursement we ended up with 40 to 45% of the final costs covered. Our experience is similar to that of our neighbors, so the estimation methods of the DEQ are behind those in the real world economy.

Again, my farm is appreciative availability of the program, but it may be a problem for many dairy farmers to fund the gap and more than a few may not be able to make the needed changes that will meet the goals of the program. Increasing the funding for the Environmental Quality Incentives Program (EQIP) in the 2002 Farm Bill was very significant, but if the legislation is to meet its goals and encourage more farmers to apply for and use the funds as intended, the payout ration must more closely approximate real world conditions.

If you are not already a co-sponsor, I urge you to join the more than 173 House members cosponsoring HR 4341 as part of a bipartisan effort to clarify that

animal manure is not a hazardous waste under the Superfund Law or its counterpart, the Community Right-to-Know Act. Congress should clarify that it never intended to jeopardize American agriculture by imposing strict, joint, and retroactive CERCLA liability on farmers for their traditional farming practices, including the use of manure as a beneficial fertilizer.

My family has always taken our responsibility to protect the environment very seriously. Dairy farmers and other agricultural producers for years have been regulated and required to have permits under the Clean Water Act, Clean Air Act and numerous state laws and regulations – but never under the Superfund Law. It is essential that Congress protect farmers and businesses that depend on agriculture from this potential threat to their livelihoods.

Workable Immigration Laws

I support the AGJobs Provisions contained in the Senate version of the Immigration Reform and I ask your support for passage of legislation that contains such language.

Estate Tax issues

Ways & Means Chair Thomas (R-CA) has proposed a compromise on the estate tax issue. He proposes to set several levels of taxes on estates. Estates of $5 million (singles) and $10 million (couples) would be exempt from taxation indefinitely. Tax on estates of $10 million to $25 million would be taxed at the capital gains rate (15% currently & rising to 20% in 2011). Estates worth more than $25 million would be taxed at twice the capital gains rate. This proposal appears to be very good for dairy farmers and I would encourage your support.

7) **Another reason we support extending the current Farm Bill is so that we can have a more clear view of the Doha Round of the WTO trade talks. We can see no reason to change our programs until we know what the world trade rules will be and, more importantly perhaps who will play by them.**

- **We support multilateral trade talks that level the playing field of dairy export subsidies, tariff protections and domestic support programs.**
- **We can't support a final agreement unless it represents a net increase in our ability to compete against our more heavily subsidized and protected competitors in the EU, Canada and Japan, as well as more balanced trading opportunities with key developing countries.**
- **We support the continuation of the dairy price support program with or without a successful Doha Round. We strongly disagree with those who claim that the price support program must be phased out or eliminated upon completion of the Doha Round.**
- **We support additional legislation to make the import assessment for dairy promotion (15 cent check-off) WTO-compliant by extending it to dairy producers in Alaska, Hawaii, District of Columbia and Puerto Rico.**

8) **We support the Dairy Export Incentive Program (DEIP) and the requirement that the Secretary of Agriculture be directed to see that the allowable amounts of cheese, butter and nonfat dry milk be afforded export assistance equal to what we are allowed under the current WTO agreement. Currently no government export assistance is being offered, even though, by law, the Secretary is directed to do so, and by agreement we are allowed to do so under the WTO agreement.**

In closing, Chairman Goodlatte, I want to thank the House Committee on Agriculture for having this series of field hearings. We know we can't explain all of our concerns here in detail, but we want to make you aware of them so that when we do provide you with additional details you will better understand our concerns. I will be happy to answer any questions or provide any additional information that you might want.

Gerald Heatwole
McGaheysville, VA 22840

Gerald Heatwole, with his wife Anita, and son Monte, operate two dairy farms in the Shenandoah Valley. The home farm, Cub Run Dairy, LLC is a 300-cow dairy, and includes two turkey houses, growing 60,000 large toms annually for the Virginia Poultry Growers Cooperative. The second dairy is a 175-cow farm in Keezletown, VA. Gerald serves on the DFA Southeast Area council board of directors, chairs the South Atlantic region, and serves on the VA SUDIA board of directors.

Gerald also serves as chairman of the board for Shenandoah Valley Electric Cooperative and serves on the Ag Advisory board of First Bank and Trust Company, a regional bank. Gerald and two other local dairy farmers, own two New Holland Agriculture equipment dealerships in Harrisonburg and Staunton, VA. The Heatwoles are members of Dayton Mennonite Church, where Gerald serves as a Deacon.

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Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

Name: Gerald A. Neatwole

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Organization you represent (if any): Dairy Farmers of America

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source: — **Amount:** —

Source: — **Amount:** —

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2004, as well as the source and the amount of each grant or contract:**

Source: _____ **Amount:** _____

Source: _____ **Amount:** _____

Please check here if this form is NOT applicable to you: ✓

Signature: Gerald A. Neatwole

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

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