Testimony of Paul Hill
Chairman, West Liberty Foods
West Liberty, Iowa
on Behalf of
The National Turkey Federation
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Good afternoon, Chairman Rooney, Ranking Member Cardoza and members of the Subcommittee. My name is Paul Hill, and I am chairman of West Liberty Foods in West Liberty, Iowa, and a past chairman of the National Turkey Federation. I want to thank the Subcommittee for inviting me to discuss the state of the U.S. turkey industry today and the challenges we will face in the years ahead.

I am excited to be offering this testimony on behalf of my company and the National Turkey Federation because I have had the opportunity to watch the development of the modern turkey industry from several different perspectives. I was raised on a turkey farm, and I have been a turkey grower my entire adult life. I also am a corn farmer, raising about 1,500 acres of corn each year. And, since 1996, I have been the chairman of a meat and poultry processing cooperative called West Liberty Foods.

West Liberty Foods was created that year when 43 family turkey farmers joined together to purchase the Oscar Mayer/Louis Rich turkey plant in West Liberty from Kraft Foods, which had announced the plant's closing earlier that year. It took an enormous leap of faith for those 43 families to join together to purchase the plant. The turkey industry was in terrible economic shape back then. By the time we officially opened our doors in early 1997, the industry was mired in one of its worst slumps ever.

Overproduction had depressed turkey prices. Grain supplies were extremely tight, forcing feed prices to levels that seemed shockingly high at the time. Not long after we began operating, the European Union closed its borders to American turkey products, depriving us of the number-one export market for turkey breast meat and further depressing turkey prices already hovering near record lows.

It took the industry – and our company – nearly 18 months to pull out of that slump. In the years that followed, West Liberty Foods was able to grow and prosper. Today, we process more than 60 million pounds annually at our facility in West Liberty, Iowa, and further process 200 millions pounds of product at the Mount Pleasant, Iowa, plant. We have built a second further processing plant in Tremonton, Utah, where we further process 165 million pounds of product. We employ more than 1,850 associates at the three plants. And, we're very proud to say our company now supplies a majority of all the turkey products sold in Subway restaurants.

We take considerable satisfaction in our success at West Liberty Foods, and we remain committed to helping the turkey industry as a whole grow and prosper. At the same time, we never let the lessons of those first difficult months stray from our thoughts, because the industry has suffered even deeper recessions during the last 15 years and, because even in a period of relative prosperity, the threat of economic hardship remains very real.

To help understand why the industry's economic situation remains so tenuous, I need to discuss briefly the structure of the industry, how it works and the fundamental conditions necessary for economic success.

Structure of the Turkey Industry

Most people would characterize the turkey industry as vertically integrated and while the assessment is relatively accurate, it fails to capture the diversity of operations that make up today's industry.

The industry is vertically integrated in the sense that the individual processors make the decision about how many turkeys will be raised and marketed, and growers raise birds in accordance with those production plans. In many cases, the vertical integration follows the classical model: the processor, or integrator, owns the turkeys throughout their lifespan. The processor provides turkeys to a grower and also supplies the feed and medication necessary to raise the bird to a mature market weight. The grower in turn provides the housing and his or her expertise in raising turkeys and is compensated by the processor based on a variety of factors, including weight gain, efficient use of feed and low mortality rates.

In other instances, turkeys are raised on a marketing contract. In this situation, the grower owns the turkeys throughout their life cycle and provides the feed and medicine, as well as the housing and production expertise. The processor then purchases the turkeys at a previously contracted price. Certain premiums may be paid based on factors outlined in the contract.

Finally, some turkeys are raised on company-owned farms. In this model, the company not only owns the turkeys throughout their life cycle and provides feed and medicine; it also provides the housing and employs growers to oversee the production.

Some companies exclusively use one model or another. At West Liberty, we offer identical marketing contracts to all our growers, regardless of whether they have an equity share in the cooperative or not. But, it also is common for companies to use multiple production models. Some will raise birds on production and marketing contracts while others will utilize a mixture of production contracts and company-owned farms.

Industry Profitability

Multiple factors affect the turkey industry's ability to sell wholesome, nutritious, high-quality turkey products profitably at a reasonable price to consumers, but three stand out: input costs, production discipline and consumer demand. When all three are in line, the industry can enjoy significant profitability. When at least two of these factors are in place – production discipline and consumer demand – as is the case today, the industry will experience at least some degree of profitability. If two of the three are out of line, profitability begins to suffer. When all three factors are askew, the economic results are disastrous. This was the case when West Liberty Foods was founded in 1996, and we experienced an even greater downturn in 2008 and 2009. And, it could be the case again within the next 12 months. Let me explain why:

Input Costs. The road to profitability begins with production costs. Feed is the most expensive of these inputs, accounting for 70 percent of the cost of raising a turkey. Turkeys are fed a mix of corn and soybean meal, with corn accounting for roughly 70 percent of the ration. When feed costs increase dramatically, the industry's profit margins shrink accordingly. If there is an oversupply of turkey or all meat proteins, or if the general economy cannot support passing the increased feed costs to customers, then the industry begins to lose money rapidly.

This certainly was the case in 2008 and 2009. Corn prices and the resulting feed costs nearly quadrupled in a span of barely two years. Smart hedging strategies kept feed costs manageable for much of 2007, but by the end of that year production costs had reached a point where virtually everyone in the turkey industry – and everyone else who produced meat and poultry products – had to pass cost increases along. It was at just this moment that the other two factors both came into play.

Production Discipline. Economists are fond of saying about the meat and poultry industry that "nothing cures high prices like high prices." By this they mean that when prices rise to a certain point, livestock and poultry producers begin to increase production to take advantage of the strong prices. This increased production eventually reaches a point where the market has too much meat protein available, or too much of a certain meat protein, and prices begin to fall. This was the case in the mid-1990s when West Liberty Foods joined the turkey industry. Feed costs were high then, too, but those high costs were the result of specific global weather events and were relatively short lived. It took the turkey industry, the pork industry and, to a lesser extent, the beef and chicken industry longer to work through the oversupply issue.

The situation in 2008 was different. The industry did not lose its discipline. Real consumer demand for turkey and all meat proteins had been rising for several years. There was no reason to believe that consumers would not support another year of production increases, so most companies made plans to grow more birds. The year began with most industry observers anticipating an overall production increase of 5 percent or more. It was at that moment that our final factor came into play.

Consumer Demand. As the general economy slid into recession in 2008, it was clear by spring that the market was softening. We saw turkey breast purchases at our largest customer, Subway, begin to decline, and the reason was pretty straightforward. Turkey for years had been one of Subway's biggest sellers, so the company understandably had not felt the need to boost turkey sales further with special promotions. Other products went on Subway's "$5 Menu," and turkey sales began to lag. Customer decisions in the collapsing economy were being driven almost entirely by price.

One of our competitors summed up the situation best when he said, "I'm putting all my breast meat in storage, and my turkey dogs are flying off the shelves."

Our most valuable product was not selling at the exact moment when our feed costs were reaching record highs. It was the perfect storm.

By the time the economy went into complete meltdown that fall, turkey companies already had begun changing their production plans. But, turning the production ship around is a lengthy process. It takes more than four months to raise a newly hatched poult into a full-grown turkey ready for processing. If you add in the lead time to set the eggs and hatch the poults, it takes a minimum of six months to fully alter a company's production plans. During those six months of 2008, the oversupply situation – especially for breast meat and whole turkeys – just kept building.

The only bright spot during this period was exports, which consumed more than 10 percent of all turkey produced in the United States and remained strong through most of 2008. Because Mexico, by far our largest customer, continued to buy large quantities of thigh and drumstick meat, dark meat prices were relatively healthy during this period. Unfortunately, that cushioned the overall blow only slightly, and by 2009 the global recession had begun to reduce our overseas sales as well. In 2008, turkey exports were valued at $481.9 million and by the end of 2009 the value was significantly reduced to $394.6 million.

Once production plans were altered in the second half of 2008, the change was dramatic. At West Liberty Foods, we cut production 50 (that's five-zero) percent. Another cooperative, with whom we had a marketing agreement at the time, shut its doors for three full months at the beginning of 2009. A cooperative in Nebraska closed completely. We were able to take on some of those growers at West Liberty Foods, and a few found other processors to work with, but many families who had been raising turkeys for generations had to quit the business entirely.

Initially, the production cutbacks did nothing to stop collapsing breast meat prices, which according to USDA had fallen more than 10 percent, from $1.17 in 2006 to $1.05 by the end of 2009. It took a $60 million bonus purchase of turkey breast meat by USDA's Agricultural

Marketing Service to slow the bleeding and to buy the industry enough time for the production cuts to be fully felt in the marketplace. This bipartisan effort was begun at the end of the previous administration and completed by the current Agriculture Secretary, and it enjoyed considerable support in Congress. All of us in the turkey industry are grateful for this important effort during such a critical time.

Overall, the industry cut production by about 9 percent in 2009 and by another 2 percent in 2010. Some individual companies may begin to increase production slightly this year, but overall no one in our industry expects any significant growth in 2011. In fact, further contraction remains an equally likely possibility.

Future Challenges

The biggest reason the industry is not more optimistic in the face of strong prices is feed costs. Corn and other feed prices have begun to rise again, going from less than $4 per bushel for corn to more than $7 per bushel in barely a year. As both a turkey producer and a corn farmer, I will tell you there is one reason for those cost increases – the federal ethanol policy.

We can find a bunch of economists to give conflicting arguments as to why feed costs have gone up, and I'll quote some of their statistics in a minute, but you really only need old-fashioned common sense to understand that the ethanol policy is driving these cost increases. When the Renewable Fuels Standard (RFS) was implemented in 2006, corn prices were around $2.50 per bushel. By the end of the first year of the RFS, prices were well above $3 per bushel and as the RFS increased, corn prices kept rising, ultimately topping out at $8 per bushel.

I know the arguments that speculative funds were what drove up corn prices, and they played a role. But, what attracted those funds to the corn market in the first place? The knowledge that the federal government had created a guaranteed market for corn-based ethanol. It's as close to a sure thing as you can get when it comes to a commodity investment.

Ultimately, farmers responded by planting more corn, and we enjoyed several years of very good harvests. Corn prices settled back a bit, though they operate at a permanently higher plateau where around $3.50 per bushel now is the "low end" of the price range. But, there is a major problem with this new dynamic. The market can only absorb the ever-increasing demand for ethanol if we have ever-increasing corn harvests. If the harvest is off only slightly, as was the case with the crop just harvested, prices begin to soar. Think about it: we just harvested the third-largest corn crop in U.S. history, and that hasn't been sufficient to prevent a stocks-to-use ratio that is at or near its record low.

There is one reason and one reason only for that: ethanol. As a percentage of the total crop, feed usage is down considerably. Exports and food consumption are in line with historical levels. But, ethanol's share of the corn crop has increased from less than 10 percent at the beginning of the previous decade to almost 40 percent today.

The 2006 to 2008 run up in corn prices cost the turkey industry more than $1 billion. See, I promised you some economist's statistics. The current run-up in corn prices will have a significant price tag as well. The ethanol debate has aroused a lot of emotion on all sides, and I would like to cut through that and get to the essence of the issue:

First, we must quit pretending that ethanol hasn't had an impact on livestock and poultry farmers as well as end consumers. It has and it will continue to have one as long as our current policies are in place.

Second, the turkey industry isn't seeking to abolish all federal support for ethanol, and I think you will find the same is true for others in the livestock and poultry industry. Some ethanol supports clearly can be abolished. It's hard to understand why we need both an RFS and a "blender's" tax credit. The RFS did more for ethanol production in 30 days than the blender's credit did in 30 years. It's time to let the blenders' credit expire. And, I think the livestock and poultry industry would have grave concerns about a significant new federal investment in "infrastructure" for ethanol. Food security is as important as fuel security, and our industry receives no infrastructure subsidy from the federal government. With a guaranteed market for their product, it would seem reasonable that the ethanol industry should be profitable enough to begin developing its own infrastructure.

What the turkey industry is looking for is reform of the existing ethanol policy, a safety net that ensures that corn prices and availability will be less volatile in the future.

This goes hand-in-hand with our third point. This isn't about cheap feed. Yes, high prices hurt us, but the volatility hurts us worse. More importantly, volatility hinders growth in the poultry and livestock industry. I heard an economist say recently that high corn prices won't hurt our industry as much this time around because we're better prepared for it. That's true – up to a point. We're better prepared because we've drastically cut production (even at a time when corn prices were dropping), and production will not ramp back up in a significant way as long as the specter of enormous feed cost swings exists.

Finally, we have to recognize that ethanol is beginning to divide rural America. Each side likes to portray this as a battle of family farmers on their side against corporate interests on the other side. The reality is that it is not just pitting large food companies against large ethanol companies. It's pitting family farmers who raise corn against family farmers who raise livestock and poultry. I see it in my own community. I see it in my own operation. The corn farmer in me likes the prices I've been getting in recent years, but the turkey farmer in me sees the real economic damage being caused by huge production cutbacks. We have to drop the "us-or-them" mentality and find common ground. The turkey industry has been willing to seek compromise since the RFS first was being debated. We put concrete proposals on the table. We have never received a single proposal for compromise from either corn farmers or the ethanol industry.

A second major challenge is the marketing rule proposed last summer by USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA). Agency officials say the rule is designed to give family farmers a level playing field when negotiating production and marketing contracts. That may have been the intent but the rule as proposed creates long-term dangers for many of the family farmers who raise turkeys under contract.

Many of you all are familiar with this rule, so I will not address it on a point-by-point basis, but I will call your attention to three aspects of the rule that, taken together, create enormous potential problems for all segments of the industry.

The first is the competitive injury provision that will make it easier to sue or bring regulatory action against poultry processors. The second is the provision that requires processors to virtually guarantee growers they can recoup 80 percent of their capital investments. The third is a series of provisions that would discourage competitive contracts in which growers can receive premiums or deductions based on the performance of the turkeys in their care.

Taken together these provisions create significant new legal and regulatory risk for the poultry processors who raise about 80 percent of all turkeys via a production contract with family farmers. The first and most obvious outcome is that contracts will be less competitive and compensation will become more uniform among growers. For some growers this might be good news, but for those who were doing an outstanding job and receiving premiums will justifiably feel cheated as a new regulation forces everyone down to a lower common denominator. As I mentioned earlier, West Liberty Foods is part of the 10 percent of the industry that raises turkeys through a uniform marketing contract, but I spent many, many years as a contract grower, and I wanted the opportunity to compete with other growers and to earn premiums for top performance.

The bigger impact will come in the long term, though. The rule creates greater economic and regulatory risk for the processors who raise turkeys under production contracts. These processors will have to find ways to minimize that risk, and since 80 percent of all turkeys are raised under these contracts, how that risk is managed will have an enormous impact on the industry. One conceivable option for processors could include reducing over time the number of farms on which they raise turkeys. It could prove safer to expand operations on those farms with the best track record, and that poses a threat for growers whose performance is far from poor but who may not meet the rigid criteria necessary for processors to operate in a higher-risk world. Another realistic option would be for more processors to raise turkeys on company-owned farms. Right now such farms make up only 10 percent of turkey production, but it is easy to envision a scenario in which the percentage is much higher a decade from now.

What is especially frustrating is that USDA promulgated this rule without conducting an adequate economic assessment of its impact. A study funded in part by the National Turkey Federation found an impact of at least $361.6 million on the turkey industry alone. Other studies found the impact might be even higher. Another study released by the National Chicken Council concluded that the rule would cost the broiler industry more than $1 billion over next five years. Finally, a study conducted by John Dunham and Associates showed job losses to the meat and poultry industry at 104,000 and would reduce the national Gross Domestic Product (GDP) by $14 billion.

USDA now has agreed to conduct an assessment, and that is a positive development. However, no one at the department has committed to submitting the study for public comment before finalizing the rule. This is an essential step if there is to be any level of confidence that the final rule truly has the interests of family farmers – as opposed to the interests of lawyers who might try to sue on their behalf – at heart.

No summary of challenges would be complete without mentioning the Environmental Protection Agency's aggressive new stance against poultry and livestock farming. The Chesapeake Bay initiative is a prime example. The agency seeks to impose new Total Maximum Daily Load requirements on farms that operate in the Bay's watershed, yet they are doing so based on outdated and incorrect models. Put in plain language, EPA doesn't know what's actually happening in the watershed, but it's going to prescribe a solution anyway.

A poultry industry representative earlier this year told a House Agriculture Subcommittee that EPA should recognize the industry's tools and programs that are improving water quality in the Chesapeake Bay watershed and across the nation. The results of the indsutry's action in this watershed are reflected in EPA's estimates that between 1985 and 2005 nutrient loads from agriculture decreased to the Chesapeake Bay, while nutrient loadings from developed lands increased by 16 percent,

Imposing burdensome mandates based on questionable data only imposes more costs, paperwork and burdens on family farmers, while achieving few real benefits for water quality.

EPA has proven so intransigent on this issue that NTF has recently joined the American Farm Bureau Federation, the National Chicken Council, U.S. Poultry and Egg Association, National Pork Producers Council, National Corn Growers Association and many others in suing the agency over the initiative. This was not an easy decision for us. Turkey farmers and processors are committed to being good environmental stewards, as evidenced by our success in the Chesapeake Bay watershed itself. This lawsuit was necessary not just to stop the agency's current action but to ensure that this wrong-headed approach is not exported to other watersheds across the nation.

How Government Can Help

Though most people in the turkey industry prefer minimal government involvement, there are ways Congress and the Executive Branch have been helping and can continue to help ensure the continued economic viability of the turkey industry.

A prime example would be in the work USDA's Natural Resources Conservation Service had done with regard to the Chesapeake Bay. Their research has demonstrated the significant flaws in EPA's modeling for the Bay and could serve as the basis for a more balanced regulatory approach that truly enhances the Bay.

AMS programs like the School Lunch Program and the 2009 bonus purchase I referenced earlier are vital. The School Lunch Program and other government feeding programs help provide school children and the underprivileged with healthy, nutritious meals. The bonus purchase program provides a mechanism for the government to purchase commodities for those feeding programs at bargain prices while providing support for an industry when it is struggling economically.

And, our partnership with the federal government on food safety is vital for consumer confidence in our food supply. While industry and the regulators don't always see eye-to-eye, the government's growing commitment to working cooperatively with processors on a science-based, risk-based inspection system has helped enhance the microbial profile of our food supply, reduce foodborne illness and maintain consumer confidence in what remains the world's safest food supply.

Thank you again for the opportunity to discuss the state of the turkey industry. I will be happy to answer any questions you may have.

Paul Hill

Chairman of the board at West Liberty Foods, headquartered in West Liberty, Iowa and NTF's chairman in 2008.

Along with being chairman of West Liberty Foods, the 12th largest turkey processor in the United States, Hill is president of Circle Hill Farms, Ltd., in Ellsworth, Iowa. He was instrumental in the founding of West Liberty Foods, a farmer-owned company, 10 years ago, which now processes more than 217 million pounds of turkey meat annually.

Hill graduated from St. Olaf College, Northfield, Minn., with a B.A. in economics. He and his wife Mary farm and raise turkeys, and they are active participants in their church and community projects.

He served six years in the U.S. Army National Guard, served on the Iowa Farm Bureau and American Farm Bureau Federation Poultry and Environmental Advisory Committee, and has served as chairman of the American Farm Bureau Poultry Advisory Committee.

The Hill's were named 1995 Iowa Master Farmers. Hill was named Farmer Cooperator Director of the Year in 2002. He is past chairman of the Iowa Agricultural Finance Cooperation.

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, 2008.

Name: Paul Hill

Organization you represent (if any): West Liberty Foods

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2008, 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, 2008, as well as the source and the amount of each grant or contract:**

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

Signature: Paul Hill

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