



**National Farmers Union
Testimony of Scott Hoese**

**Before the
U.S. House of Representatives Agriculture Subcommittee
on Livestock, Dairy and Poultry**

To Review Economic Conditions of the Dairy Industry

**Tuesday, July 21, 2009
Washington, D.C.**

**STATEMENT OF SCOTT HOESE, DAIRY FARMER
NATIONAL FARMERS UNION
BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON LIVESTOCK, DAIRY AND
POULTRY
CONCERNING: REVIEW OF ECONOMIC CONDITIONS IN DAIRY INDUSTRY
JULY 21, 2009**

Good morning, Mr. Chairman and members of the committee. My name is Scott Hoese, I am a dairy farmer from Mayer, MN. My wife, son and I have a Century farm that consists of more than 600 acres, 120 milk cows and an additional 125 heifers and young stock. We grow all of our own feed in addition to some corn and soybeans. We expanded our operation three years ago, from 65 cows to the current 120. I currently serve as the president of Carver County Farmers Union, as a township supervisor, on the board Bongards' Creamery and am past president of the Minnesota Association of Soil and Water Conservation Districts. I am here today on behalf of National Farmers Union (NFU) – a nationwide organization representing more than 250,000 farm, ranch and rural residents.

In 1908, a small number of dairy farmers in Carver County, Minnesota decided to organize a farmer-owned cooperative creamery, Bongards' Creamery. This farmer-owned cooperative has two processing facilities in Bongards and Perham, Minnesota where we produce approximately 60 million pounds of natural cheese each year and a variety of top quality whey powders. My family has been part of this coop since 1962 and I currently serve as a director. The initial goals were simple and continue to be our focus today: produce the freshest, most wholesome and flavorful dairy products while getting a fair return for our raw milk.

I applaud the subcommittee for scheduling this hearing and providing producers the opportunity to speak directly to you. Recently, the Minnesota Farmers Union held a number of "No Bull" dairy action sessions to hear directly from dairy farmers and gather suggestions to improve dairy farm-gate price and profits. As a producer, it has been frustrating, to say the least, to weather one of the worst economic periods in 30 years yet it seems as though our society as a whole has not grasped how desperate our situation is.

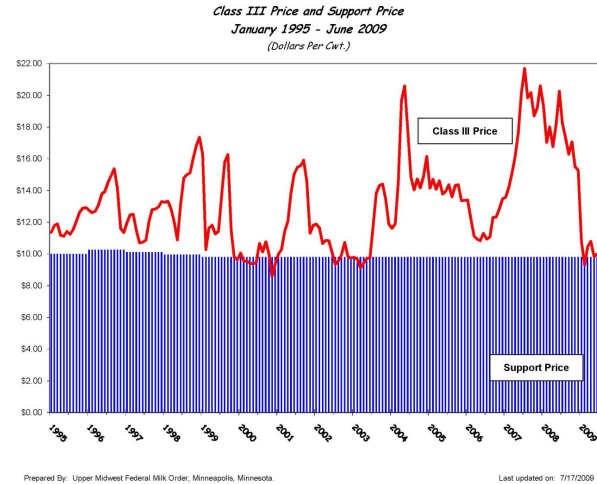
Dairy farmers of all sizes and across all regions of the country are enduring an unprecedented disaster. From Minnesota to California and Texas to Vermont, the current situation is untenable. Equity is rapidly disappearing, market prices remain at 1970 levels, creditors are cutting off producers – yet there is no relief in sight. Since the first of the year, two dairy producers in California have committed suicide as due to the gravity of their financial situation and the future outlook. This situation is unlike any experienced in the past and the width and depth cannot continue to be ignored.

My state is the sixth largest dairy state in the United States, milking about five percent of the national herd. While many large dairy states have witnessed a decrease in their herd, Minnesota has increased cow numbers for the past four consecutive years. Despite the increase in herd size, the number of Minnesota farmers milking today is fewer. Our states' economic engine relies on the dairy industry. For every dollar from dairy production and processing, about \$2 is generated in statewide economic activities.

The multiplier effect of the dairy industry on Minnesota's economy is a total economic output of nearly \$9 billion and almost 40,000 jobs. Unfortunately, the 2009 market collapse has resulted in an average of \$12.60 per hundredweight (cwt) for Minnesota dairymen for the first four months of the year according to the Minnesota Department of Agriculture – the lowest market level since 2002. One of the untold stories with

today's dairy crisis is the impact it has had off the farm – jobs are lost and rural communities struggle to survive if even just one dairy producer is forced to liquidate their operation.

As quickly as dairy prices peaked last year, they have just as quickly collapsed and have been well below the cost of production. The rollercoaster market dairy producers have been riding seems to be getting more severe with each passing year – with the high's not lasting long enough to mitigate the low's. There are a variety of reasons why the dairy industry is in the economic condition it is in and there is no single silver bullet to solve our problems. An uncompetitive marketplace, industry consolidation, market manipulation, rising imports of dairy proteins, and an insufficient safety net are some of the major factors resulting in our current economic situation.



MAILBOX PRICES

YEAR	JUNE PRICE
1999	\$11.42
2000	\$9.46
2001	\$15.02
2002	\$10.09
2003	\$9.75
2004	\$17.68
2005	\$13.92
2006	\$11.29
2007	\$20.17
2008	\$20.25
2009	\$9.97

*National Avg. FMMO prices,
Source: Cheese Reporter*

Farmers Share – Retail Prices

Each month NFU tracks and publishes the farmer's share of the retail food dollar. Our latest data shows consumers paying \$4.99 for a pound of cheddar cheese while the farmer receives less than \$1.00; farmers receive \$0.97 out of the \$2.99 consumers pay for a gallon of fat free milk. At a time when more consumers are eating at home, thereby increasing retail dairy product sales, producers are losing money on every gallon of milk sold. To make the situation more painful, producers read media stories of double-digit profit margins for dairy processing companies. Dean Foods Company reported its first quarter profits for 2009 more than doubled from the same period in 2008. Kraft Foods Inc. reported 2009 first quarter profits up 10 percent, earning \$660 million for the first three months of the year. It was just a year ago that Kraft and other members of the Grocery Manufacturers Association launched a multi-million dollar media campaign blaming higher retail food costs on farmers and ethanol. NFU

has called upon Congress to convene hearings to reexamine the impact of food prices on American families. Since commodity prices have collapsed and retail food prices have not tracked in similar fashion, a full examination is long overdue.

Supply vs. Demand

Much debate over today's situation has been centered on whether U.S. farmers are producing too much milk for current demand. Unfortunately, the commercial disappearance data used by USDA does not account for the imported MPC, casein and caseinates for food usage as reported in a 2004 USDA Agricultural Marketing Service (AMS) report titled, "*Milk Protein Products and Related Government Policy Issues*". The report stated that in 2003, the amount of imported milk protein concentrates accounted for 5.9 percent of the total U.S. milk protein production. The report concluded that milk protein imports is equivalent to approximately five percent of our milk protein production.

According to a recent letter from Secretary Vilsack to the National Family Farm Coalition, domestic milk marketing's in 2008 totaled 188.8 billion pounds. Data from USDA's Economic Research Service shows commercial disappearance on a milkfat basis totaling 193 billion pounds (184.3 billion pounds of domestic use

and 8.8 billion pounds of exports). Vilsack cites this data to underscore his point that domestic marketing's are more than adequate for domestic use. Where USDA's data is flawed is in the lack of accounting for the five percent equivalent of U.S. milk production in the form of imported milk proteins as stated in AMS's 2004 report. Five percent of the 188.8 billion pounds of milk marketed in 2008 totals close to 9.5 billion pounds. Adding the 9.5 billion pounds of equivalent imported milk proteins increases the commercial disappearance number to 202.5 billion pounds.

The 2008 commercial disappearance number of 202.5 billion pounds appropriately includes the imported milk protein ingredients used for food. After removing the export commercial disappearance of 8.8 billion pounds, the total domestic commercial disappearance is 193.7 billion pounds. Comparing the 188.8 billion pounds of milk marketing's verses the 193.7 billion pounds of domestic commercial usage, we are a net deficit producer by nearly 5 billion pounds. If we produce just 188.8 billion pounds and use 202.5 billion pounds for both domestic usage and exports, we are 13.7 billion pounds short on production. As you can see, by using more accurate data to account for imported proteins used for food production, it is clear that U.S. dairy producers are not oversupplying the market.

Imports

For many years, NFU has supported closing the milk protein concentrate (MPC) and casein loophole created by the Uruguay Round agreement, which allows for the importation of MPC and casein tariff-free. The overflow of imported, ultra-filtered dried protein product displaces American-produced milk in the production of dairy products. MPC was a relatively new product during Uruguay Round negotiations and after implementation of World Trade Organization (WTO) rules in 1995 became commercially viable.

A lack of enforcement by the U.S. Customs Service has allowed dairy protein blends to be imported in circumvention of U.S. tariffs and tariff-rate quotas. Much of the imported dairy protein blended products are essentially equivalent to skim milk powder and do not satisfy the common or commercial meaning of the term "milk protein concentrate." Therefore, they should be subject to tariff provisions covering powdered milk imports. Moreover, a 2001 Government Accountability Office (GAO) report stated ultra-filtered milk is not nutritionally equivalent to fluid milk nor has the product undergone mandatory safety tests under the Food and Drug Administration's "Generally Recognized as Safe" rules.

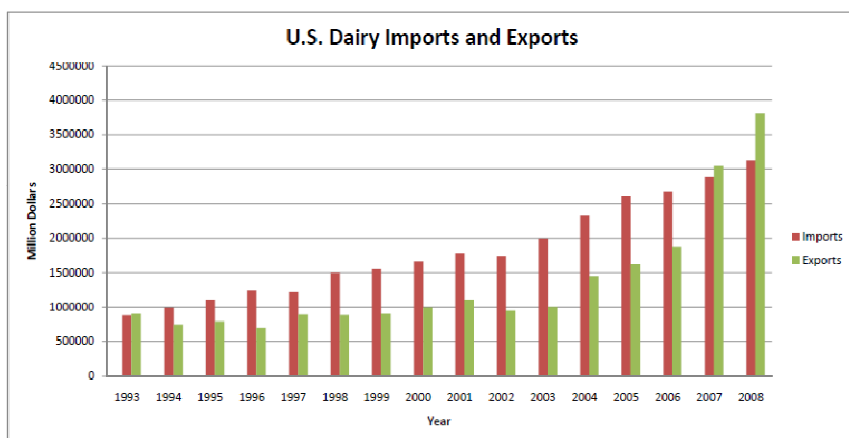
Dairy Imports

Milk Equivalent (Billion Lbs.)	Factor	2002	2003	2004	2005	2006	2007	2008
CHEESE	x10	4.75	4.75	4.71	4.60	4.54	4.35	3.75
CASEIN	x39	7.93	8.94	8.72	8.36	6.95	7.75	10.21
BUTTER	x4.2	0.14	0.13	0.22	0.16	0.16	0.15	0.13
MPC	x22	2.01	2.34	2.12	2.67	3.04	2.96	3.04
LACTOSE	x5.5	0.05	0.08	0.06	0.06	0.07	0.07	0.09
TOTAL		14.88	16.24	15.84	15.85	14.76	15.28	17.22
U.S. MILK PRODUCTION	(Billion)	169.758	170.394	170.934	176.989	181.787	185.602	189.892
PERCENT OF U.S. PRODUCTION		8.77%	9.53%	9.27%	8.95%	8.12%	8.23%	9.06%

**UNITED STATES DEPARTMENT OF AGRICULTURE FAS AGRICULTURAL IMPORT COMMODITY
AGGREGATIONS**

While some argue that imports do not have a significant impact on domestic dairy prices and point to recent export data, it is important to understand where we have been and where we are headed. According to the Federal Reserve, the dollar lost 40 percent of its value from 2002 – 2008 and in 2008 was at a 30-year low according to USDA, compared to other major currencies. The devaluation of our currency made the prices of

U.S. commodities increasingly competitive abroad. In 2007 and 2008, we witnessed record agricultural exports in terms of volume and value despite record high domestic market prices. As economies across the country were experiencing strength and growth, a new demand was created for food commodities. The new middle class populations in Asia, Latin America and Africa were demanding an improved diet including meat and dairy products. Two major factors have changed significantly since 2007 and 2008: economies across the world are in the midst of a severe recession and the value of the U.S. dollar has been strengthening. Increasing and expanding exports is important to American farmers, but in looking at the chart below, dairy imports have outpaced exports 13 out of the past 16 years. The impact of imports must become a central part of the discussion when trying to address today's crisis.



Source: USDA-FATUS

Chicago Mercantile Exchange Reform

In June 2007, the Government Accountability Office issued a report on the spot cheese market titled, *“Market Oversight Has Increased, But Concerns Remain About Potential Manipulation”*. Since the demise of the National Cheese Exchange (NCE) due to manipulation allegations, the CME is where spot cheese prices are determined, impacting virtually all cheese traded in the U.S. as well as impacting the price producers receive for their milk. Despite these significant influences, it is typically less than 1 percent of the national cheese production is traded on the CME. GAO concluded, *“Because the CME spot cheese market remains a market in which few daily trades occur and a small number of traders account for the majority of trades, questions exist about this market’s susceptibility to potential price manipulation.”* In its report, GAO recommended USDA reduce the redundancy that exists in the NASS survey of cheese prices, improve the timeliness associated with the cheese prices survey’s and implement an audit for the survey. To date, we are unaware of efforts within USDA to implement GAO’s recommendations.

GAO highlighted the lack of transparency on the CME by identifying how the market involves daily anonymous trading compared to the NCE where cheese traded once a week with the identities of the traders made public. The concerns of manipulation that led to the demise of the NCE remain prevalent at the CME including, low trading volume and a small number of entities making the trades. GAO specifically cited trading at the CME spot cheese market being concentrated among a small number of entities, primarily large companies and cooperatives in the cheese and dairy industry. The ability of a handful of players to influence the spot cheese market has a significant negative economic impact on all producers. If the CME was a more open and honest market, more businesses would trade and increase the volume to create a more accurate and reliable market that better reflects the actual milk production in the United States. I encourage the subcommittee to review the GAO report and utilize it as a tool in striving to eliminate manipulation from dairy markets.

On December 16, 2008 the Commodity Futures Trading Commission (CFTC) announced a \$12 million penalty levied on charges of attempted manipulation of the Class III milk futures contract and exceeding speculative

position limits in that contract. CFTC found attempted manipulative practices occurred from May 21 through June 23, 2004 on the CME Cheese Spot Call market. This settlement made public just 18 months following the publication of GAO's report demonstrates the need for the federal government to restore fair, transparent and open markets for America's dairy producers.

Competition

Consolidation within the agricultural industry has been on the rise recent years and has brought about the demise of thousands of independent family farms. Independent producers are finding it increasingly difficult to participate in a fair, open and competitive market. The consolidation trend has spread beyond the farm gate and now threatens independent retailers. Since 1999, National Farmers Union has commissioned a series of studies by the University of Missouri-Columbia Department of Rural Sociology to gauge concentration in agricultural and retail markets. The latest update, released in April 2007, reveals that the top four firms in most agricultural sectors continue to tighten their strong-hold.

<u>TOP DAIRY PROCESSORS IN U.S. & CANADA</u>	
<u>Company</u>	<u>Annual Sales*</u>
1. Dean Foods	\$10,106 million
2. Kraft Foods	\$4,400 million
3. Land O' Lakes	\$3,901million
4. Saputo Inc.**	\$3,461million

Source: * *Dairy Foods: Dairy 100* (2006)
Notes: ** Over 40% of Saputo Inc. plants are in Canada.

Due to increased levels of concentration and consolidation, there is a lack of competition in the dairy sector in the U.S. A few major companies dominate the market, leaving producers and consumers to suffer as a result. In order for the dairy industry to be viable and sustainable in the future, policy decision-makers need to take immediate steps to foster and restore

<u>FOOD RETAILING</u>		CR5 = 48%*
<u>Supermarket</u>	<u>Grocery Sales*</u>	
5. Wal-Mart Sores	\$98.7 Billion	
6. Kroger Co.	\$58.5 Billion	
7. Albertsons, Inc.	\$36.3 Billion	
8. Safeway, Inc.	\$32.7 Billion	
9. Ahold USA, Inc.	\$23.8 Billion	

Source: * *Progressive Grocer's Super 50* (5/1/05)

competition in the marketplace. Economic power concentrated in the hands of a few players has essentially eliminated the price system. The farm-gate price is no longer cost plus profit; instead it is a command economy with a few corporate players dictating farm price.

Make Allowance

Dairy producers and cheese processors are partners, each dependent upon the other. However, both, not just one or the other, must sustain profitability to achieve a healthy dairy industry. Farmers receive no assurance of profitable milk prices under federal milk market order system, leaving the question as to why should processors be given special treatment. National Farmers Union has opposed all proposals to increase the make-allowance for processors because we believe it gives an unfair advantage to processors and will be economically harmful to producers.

The current make allowance system sends a false signal to processors to continue production regardless of market demand and provides a strong incentive for processors to run as much raw milk as possible through a

plant regardless of market conditions. The result from this system is that it puts the needs of the processor at odds with the needs of the dairy producer. Too much milk reduces the price to the dairy farmers and milk shortages decrease the amount of milk available to the processor.

The make allowance system should be reformed so that it provides benefits to the producer and processor. Farmers Union has long advocated for the establishment of a variable make allowance that would link processor and producer prosperity. A variable make allowance would increase significantly when milk prices are high, thereby giving an incentive to the processor to continue production because the return would be greater. However, when prices are low the make allowance would decrease and send a signal to the processor to limit production in order to allow demand to catch up with production. We believe a variable make allowance is a "win-win" proposal because it would enable producers and processors to make a higher return when milk prices rise.

As long as the manufacturing allowance is fixed at the processor's cost plus a return on investment, and is paid for by farmers, the processing segment of the industry will be unconcerned with market signals. We need a system that works with the marketplace at all levels: producer, processor, wholesaler, retailer and consumer to provide an equitable, stable and viable economic environment for all segments of the dairy industry.

NASS Survey

In April 2007, NFU sent letters to USDA's Inspector General and then-Secretary Johanns regarding concerns with reports that prices reported for non-fat dry milk (NFDM) by NASS were consistently below actual prices observed in the marketplace, resulting in lowered prices paid to dairy producers. Because the NASS reports are directly linked to the prices received by dairy producers through the federal order system, any misreporting, underreporting or inaccurate reporting of NFDM prices is a significant pricing problem. When the misreporting became known, NFU called on USDA to take the following actions:

- Immediately review price reporting procedures for NFDM from July 2006 to the present (April 2007);
- Calculate, with publicly available documentation, the amount of revenues lost by producers as a result of the misreporting;
- USDA should review milk pricing programs, including why they reported prices, to assure that dairy commodity prices are accurately and fairly reported.
- Explanation as to why the department had not implemented the auditing authority granted by Congress in 2000 and 2002;
- Calculate, with publicly available documentation, the impact of all classes of milk and adjustments to monthly prices for Class I, Class II and Class IV.

To allow such serious agency errors to occur at the expense of dairy producers should not be tolerated.

Policy Options

Time is of the essence for dairy producers. Many continue to lose \$100-\$200 per dairy cow per month with no immediate increase in the market on the horizon. Regardless of operation size, many producers have been issued notice from feed suppliers that they will no longer receive feed and creditors are terminating lending options. Since dairy prices peaked last year, the market has precipitously collapsed to historic low levels and is now well below the cost of production. NFU supports a comprehensive dairy policy that accounts for dairy profitability, income stabilization, limitation on imports, competitive markets and supply-inventory management.

In 2007, NFU hosted a dairy summit of producer-based organizations to seek solutions, both long and short term, for dairy producers. The following three core principles were identified and agreed to by participating organizations and remain applicable in today's environment:

- Return on investment greater than cost of production, PLUS a profit from the market;
- Reform of the Federal Milk Marketing Order system; and
- Restoring competition to a non-competitive dairy market.

The NFU board voted in June to encourage Congress to pass a dairy stimulus package to provide an adequate safety net for producers in addition to establishing an inventory management program. Most importantly, the board expressed the need for producers to receive an immediate financial lifeline to sustain their livelihoods through this unprecedented situation. A suite of policy options exist to ensure producers will survive this devastating economic period. Options to achieve the above mentioned principles are outlined below, categorized by short-term action and long-term action.

Short Term Options:

- Establish safety-net support price that is fair and equitable to all producers – Establish an emergency Class III floor price of \$18/cwt by existing authorities of the Secretary for a period of 6-9 months. During this period, USDA should launch the FMMO review as established in the 2008 Farm Bill and CFTC should launch additional investigations into potential manipulation on the CME. A long-term supply management program must be established in tandem with the emergency floor.
- Continuation of the counter-cyclical Milk Income Loss Contract (MILC) program – Legislation has been introduced in the Senate that would double the MILC payment rate short term. This provides a quickly deployable lifeline in an effort to prevent additional dairy bankruptcies.
- Eliminate the make allowance. If not eliminated, make it variable and tied to producers' cost of production.
- Require the NASS survey to be audited periodically.
- Maintain standards of identity on dairy products and move to increase fat content standards in fluid milk. Milk is naturally produced with fat content of 3.5 or higher, yet most of the whole milk sold in the U.S. has been reduced to 3.2.
- Deploy low-interest and emergency loans, including a foreclosure mitigation program to stem the tide of loan foreclosures.
- Purchase dairy products and hamburger for donations to food banks and other nutrition programs.
- Allow producers to label milk as free of artificial growth hormones.
- Require accurate recording and publishing of import data from ERS.
- Ensure imported dairy protein blended products are accounted for and categorized appropriately according to the common or commercial meaning of the term "milk protein concentrate," not allowed to disguise skim milk powder MPC to avoid tariffs and the tariff rate quota.

Long Term Options

- Efficient transmission of price signals should be established. Today's market is non-functioning with imbalance of buyers/sellers.
- Pass the Milk Import Tariff Equity Act to address unlimited imports flooding U.S. domestic market.
- Include California and all regions/areas in the FMMO.
- Correct pooling/de-pooling provisions in the FMMO.
- Eliminate bloc voting.
- Allow "no" vote on amendments, yet maintain FMMO.
- Do not place financial burden of transportation onto producers.

- Establish three-part pricing formula to include: cost of production, Consumer Price Index and Chicago Mercantile Exchange.
- Resolve distribution and supply management challenges.
- Repeal forward contracting authority.
- Support funding for academic antitrust research.
- Intensify review process for proposed mergers.
- Promote smaller coops and increase oversight of coop management to ensure interests of producers are met.
- Passage of the Federal Milk Marketing Improvement Act of 2009 (S. 889)
- Eliminate authority for dairy import promotion assessments.

As stated at the beginning of my testimony, today's economic conditions for dairy producers can be attributed to many factors. As such, there will be no single action by Congress or the Administration to resolve all of the challenges. I hope the series of hearings this subcommittee conducts will provide you with all the necessary resources of ideas to create a suite of options to ensure both short term survival and long term prosperity for America's dairy farmers. Thank you for the opportunity to be here today.