Testimony of Joaquin Contente
National Farmers Union

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To Review Economic Conditions of the Dairy Industry

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STATEMENT OF JOAQUIN CONTENTE, DAIRY FARMER
NATIONAL FARMERS UNION
BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON LIVESTOCK, DAIRY AND POULTRY
CONCERNING: REVIEW OF ECONOMIC CONDITIONS IN DAIRY INDUSTRY
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Good morning, Mr. Chairman and members of the committee. My name is Joaquin Contente. I own and operate a dairy farm with my brother Tony in Hanford, which is just West of Fresno in the Central Valley of California. I currently serve as a president of the California Farmers Union, a state chapter of the National Farmers Union (NFU). I serve on the board of the California Dairy Campaign (CDC) which represents dairy farmers throughout California. The California Dairy Campaign is a member organization of California Farmers Union and a member of the dairy subcommittee of the National Family Farm Coalition (NFFC).

My dairy has been in my family since the 1920's, but the future of my dairy and others throughout California and the nation are in serious jeopardy due to record low producer prices. In my county alone 25 dairies have either filed or are in process of filing for bankruptcy and many more are closer to bankruptcy each day. Many of the dairy operations near bankruptcy today have been in operation for several generations. They are family dairy farms that have weathered many economic storms, but the crisis they confront today is unparalleled in our history. Two dairy producers in my state have committed suicide and many more are undergoing unimaginable stress because producer prices cover just 50 percent of the average cost of production in California.

California leads the nation in dairy production generating more than $61 billion in economic activity and more than 434,000 full-time jobs. The dairy crisis is adversely affecting all the related businesses that supply and provide services to dairy producers. Dairy producers across the country face the same grim outlook due to record low producer prices that cover just a fraction of the average cost of production.

Mr. Chairman, I commend your leadership for holding this series of hearings to address the economic conditions in the dairy industry because the dairy crisis becomes more serious each passing day. In order to end this crisis it is vital that dairy producers come together to agree upon policy changes that will lift our industry out of this deepening crisis. In my lifelong history as a dairy farmer I have never seen prices remain this far below our costs for this long and I have never seen so many dairy producers so desperate for relief.

I have found that there is considerable and widespread consensus among dairy producers and their allied industries about what should be done to improve federal dairy policy end this crisis. The California Dairy Campaign launched a letter writing campaign in May to call attention to the ongoing dairy crisis and offer solutions to end it. Producers and allied industries alike joined the letter writing effort to urge President Obama and leaders in Congress to work together to provide relief to dairy producers. Thus far we have sent more than 300 letters to members of the House and Senate Agriculture Committees and President Obama calling for an increase in the dairy support purchase price and the establishment of an inventory management program.

A number of counties throughout the California, including some of the biggest dairy producing counties like Tulare, Kings and Merced, have passed a dairy resolution put forward by CDC and CFU to raise public awareness about the dairy crisis and call for specific actions to end it. I have included a copy of the California dairy resolution in its entirety in my testimony. Local officials understand the profound impact that the dairy crisis is having on communities throughout the state. The dairy resolution puts forward solutions to end the crisis by calling for an increase in the dairy support purchase price to reflect today's cost of production; implementation of fair tariffs on unregulated imported dairy solids; greater market transparency; and the establishment of an inventory management program. I will outline each of these solutions in my testimony today.

Increase the dairy support purchase price

In order to be effective, the dairy support purchase price must factor in today's cost of production so that is can provide a meaningful safety net during crisis like the one faced by producers across the country today. We support a temporary emergency floor price of $18 per hundredweight to provide immediate relief to producers. We call for an increase in the federal support purchase price to the level included in the Milk Income Loss Contract (MILC) program, which is the Boston Class I price plus the feed adjuster.

The federal government supports the price of dairy products at $9.90. This is the price milk producers received 30 years ago. We call upon Congress to act quickly to adjust the federal purchase price so that it includes the current cost of production, not the costs paid to producers more than 30 years ago.

The Office of Management and Budget (OMB) during the last administration publicly stated that the price support needs to be at the cost of production. We call upon Congress and the Obama Administration to act quickly to adjust the federal purchase price so that it includes today's cost of production, not the costs paid by producers more than 30 years ago.

The recent devastation of the dairy industry can be attributed to a number of factors including the financial meltdown that began last fall, rising concentrated dairy imports, a lack of competition in the marketplace, consolidation, rising input costs and other factors. To be an effective safety net, the price support program must be increased in response to rising production costs.

The U.S. is already a net deficit milk producer. Federal dairy policy should foster a healthy and viable domestic milk supply because each cow in the U.S. generates $20,000 per year to the national economy. In these uncertain financial times, it is critical that dairy producers receive a fair price that is based on their full cost of production. An equitable price support that more closely reflects the prevailing cost of production would be an important first step in ending the dairy crisis.

Implement Fair Tariffs on Unregulated Dairy Solids

Concentrated dairy imports for January and February of 2009 surged upward more than 70 percent compared to 2008 despite record low producer prices. Much attention has been paid to the decline in dairy exports. But rising imports of concentrated dairy proteins are the real threat to the future of our domestic milk supply. With these imports a little goes a long way in displacing domestic milk production and most do not meet basic food safety standards.

It is difficult to comprehend the impact of concentrated dairy imports because these imports, including milk protein concentrate (MPC), casein and caseinates for food usage, are not included in the commercial disappearance data issued by USDA. A 2004 USDA Agricultural Marketing Service (AMS) report titled, "Milk Protein Products and Related Government Policy Issues" stated that the amount of imported milk protein concentrates accounted for 5.9 percent of the total U.S. milk protein production. The report concluded that on average milk protein imports are equivalent to approximately five percent of our domestic milk protein production.

The U.S. dairy market is the world's largest single commercial dairy market. This market last year reached and exceeded 200 billion pounds of milk including exports. However, the USDA ERS fails to include any usage data for casein, caseinates and MPC in its commercial disappearance of milk data. Therefore, the commercial disappearance or utilization reports from USDA ERS are not complete or accurate. Once all the different categories are included in the commercial disappearance calculation such as casein, butter, MPC, and lactose the total for imports surpasses 15 billion pounds of milk equivalent or more than 7 percent of U.S. milk production. Just a few percentage changes in milk consumption can have a significant impact on producer prices. Concentrated dairy imports amount to more than 7 of our domestic milk production and have a substantial impact on the prices received by U.S. dairy producers and have made our country net deficit in milk production.

Dairy producers have fought for years to pass legislation to regulate dairy imports by supporting passage of the "Milk Import Tariff Equity Act." So far, dairy processors and food manufacturers, with their well funded lobbying firms, have fought off any regulation. To end the dairy crisis, lawmakers need to direct their attention to the dairy imports that are flooding our market and forcing so many operations to the brink of financial collapse.

As consumers become more interested in where their food comes from, a trade loophole is allowing a flood of concentrated dairy imports from far off places. Our country already relies on dairy imports to meet our domestic needs, and if action isn't taken soon we are going to become even more dependent on imports.

Mandate Greater Market Transparency

In order to establish an effective dairy price discovery system the federal government must restore fair, transparent and open dairy markets. The consolidation that has occurred over the past couple of decades has eliminated market competition to the point that now the last one percent of our daily milk production determines the price of all of the milk produced regardless of prevailing market demand for dairy products.

A handful of traders set the prices for cheese and butter on the Chicago Mercantile Exchange (CME). This thinly traded market operates for only a few minutes five days per week yet it is the mechanism that sets all milk futures contracts. The CME completely lacks transparency. Traders use code names to guarantee their anonymity. Capitalism and the interests of society are trumped by a handful of traders that are self-regulated with virtually no over site. Dairy producers across the country are very concerned that the lack of federal oversight and transparency at the CME has led to market manipulation, and created a highly volatile market that negatively impacts dairy producers.

Due to the lack of transparency at the CME, producers that may be economically impacted by anti-competitive trading practices, have no recourse to independently inquire or investigate the lack of competition in the marketplace. If the CME was more open and transparent, more businesses would trade, and the sales volume would increase fostering a more accurate and reliable market that better reflects the actual value of milk in the United States.

In June 2007, the Government Accountability Office (GAO) issued a report on the spot cheese market titled, "*Market Oversight Has Increased, But Concerns Remain about Potential Manipulation*." The 2007 GAO report documented that few daily trades occur on the CME and a small number of traders account for the majority of trades. The report further concluded that the CME is susceptible to potential price manipulation.

One of the greatest challenges facing U.S. producers and every other producer in the world is consolidation and concentration of the marketplace, which also drives market globalization. Capitalistic markets function properly when there is a balance of buyers and sellers. There are about 60,000 dairy farms marketing milk today through 200 cooperatives. Half a century ago, there were 180,000 dairy producers marketing through 1,000 cooperatives. While the number of farms and cooperatives continue to decline, the marketing presence of farmer-owned dairy cooperatives has actually expanded during the past generation. Despite this expansion there is less competition vying for producers at the co-op level, with more intervention by non-cooperatives and non-farmer controlled businesses.

Dairy cooperatives continue to grow in size and form strategic alliances with private entities. For example, my own cooperative, Land O' Lakes, sells a large portion of their cheese to Kraft Foods. The largest cooperative, Dairy Farmers of America, has ongoing agreements to supply milk to Dean Foods and Leprino Foods, and continues to expand its relationship with Fonterra. Cooperatives justify their actions by claiming they are subject to the growing demands of retailers. Wal-Mart, for example, wishes to consider no more than two suppliers for each food product it features in its stores across the U.S. The consolidation and concentration not only harm producers through lower prices, but also negatively impacts consumers with less choice at the grocery store.

In most U.S. metropolitan areas, one company, Dean Foods, has acquired the majority of fluid plants. Two corporations dominate the cheese sector; Kraft Foods at the retail level and Leprino Foods at the food service level. Regardless of which cooperative a U.S. producer markets his milk, at the end of the day the vast majority of milk is purchased by only three major buyers that dictate each market. Dean Foods dominates the fluid market, Kraft owns the retail market and Leprino runs the food service market. Until steps can be taken to end the stranglehold that these three entities have on the three major components of the dairy sector, competition will be stifled and producer prices depressed.

Economic power concentrated in the hands of a few players has essentially eliminated the price system, which capitalism is thought to rest. The farm-gate price is no longer cost plus profit; instead it is a command economy with a few corporate players dictating farm price. The loss of producer economic power is best illustrated by the widening gap between retail prices and farm-gate prices. While consumers continue to experience sticker-shock on dairy products, dairy producers are left with a shrinking percentage of the consumer dollar.

Many organic dairies throughout the country are also struggling due to the dairy crisis. Many have seen the price they receive for organic milk decrease substantially and are now subject to production caps. Organic dairy producers have invested heavily to meet organic standards, but now that many of the same corporate processors have entered the organic market, these producers are also struggling due increasing consolidation and concentration.

<u>Establish an Inventory Management Program</u>

Inventory management is sorely needed now more than ever. At the turn of the century the federal order adopted the California style make-allowance structure. This pricing mechanism establishes cost of production values for plants. These values remain constant whether the market is short or long. Plants become isolated from market conditions and are decoupled from capitalistic signals in regard to supply and demand.

Since the loss of parity in 1981, the gap between retail and farm-gate prices has continued to widen dramatically. As the mid 1990’s approached, volatility constantly increased due to several factors including consolidation; introduction of futures contracts, and the U.S. became a net-importer. Establishing a milk inventory management program will ensure the stability of the marketplace and provide sustainability for all in the dairy industry and these benefits will also be enjoyed by retailers and consumers alike.

California dairy producers have been in a constant growth mode. When prices are good, we add cows; when prices go down, our bankers tell us to add cows in order to cash flow, even though, historically, California has had some of the lowest mail box prices in the nation. An effective inventory management system would provide an incentive for dairy producers to manage milk production to meet prevailing market demand. Producer price volatility is a threat the dairy producers in California and across the nation. The current system provides an incentive for dairy producers to simply maximize their production, especially when producer prices are high which can lead to lower prices due to the increase in supply that results. An inventory management program could provide an incentive for smart growth in milk production that is based upon current market conditions. It would lead to the end of the boom and bust cycles that have plagued dairy producer prices for so many years and provide some stability in the future for all producers.

Conclusion

The outlook for dairy producers in California and across the country is grim unless Congress acts quickly to reform federal dairy policies. We call upon Congress to increase the dairy support price to factor in today's cost of production; address rising unregulated imports of concentrated dairy proteins; mandate greater market transparency and establish and inventory management program to balance milk supply with market demand.

We thank you Mr. Chairman for holding this important series of hearings to address the difficult and unprecedented economic conditions dairy producers face today. We greatly appreciate the opportunity to testify today and look forward to working with members of the House Agriculture Committee to end the dairy crisis and sustain our domestic milk supply in the future.

California Dairy Resolution
Relative to dairy producers.

Whereas, California has been the nation's leading dairy state since 1993 and is ranked first in the U.S. in the production of total dairy product, butter, ice cream, yogurt, nonfat dry dairy product, and whey protein concentrate and is second in cheese production, and

Whereas, the dairy industry provides an economic impact of an estimated national average of $20,000 per cow per year, primarily in local economies, and

Whereas, dairy farming is the leading agricultural commodity in California generating more than $7 billion in revenue each year, and

Whereas, the California dairy industry generates more than $61 billion in economic activity and more than 434,000 full-time jobs, and

Whereas, the absence of profitable prices in the dairy industry for farmers, the lack of competition in dairy product processing ownership, as well as outdated regulations are causing an economic crisis among California dairy producers, and

Whereas, since last year, the price that dairy product processors pay farmers for their dairy product has dropped as much a 50 percent, and

Whereas, the primary safety-net for California dairy producers is the federal dairy product price support program of $9.90 per cwt, and

Whereas, the federal dairy product price support program does not adequately provide a safety net due to the fact that it is based on production costs from thirty years ago, and

Whereas, the federal government in 2006 implemented an ethanol policy mandate that has increased all feed costs to dairy producers in California, and

Whereas, the federal dairy product price support program does not account for this new federal energy mandate, and

Whereas, the federal dairy product price support program should maintain market prices near average operating costs in order to be successful. This will ensure that efficient producers are able to stay in business until prices recover; however, few efficient producers will have the protection at the current price support level, and

Whereas, California dairy product prices are set by the Chicago Mercantile Exchange (CME) cash cheese exchange. A June 2007 General Accounting Office (GAO) report on the CME states that the CME is thinly traded and is not a very competitive market. As a result, the CME should be reviewed and analyzed to determine if it is an effective and transparent price discovery mechanism; and

Whereas, the federal dairy product price support program needs to be at an adequate level to ensure California dairy producers have a viable, competitive and stable market free of manipulation, and

Whereas, a significant loss of capacity would create a dependence on imported dairy product and other dairy products and reduce our nation’s food security, and

Whereas, concentrated dairy imports for January and February of 2009 surged upward more than 70 percent compared to 2008 despite record low producer prices.

Resolved by the Senate and the Assembly of the State of California, jointly, That the Legislature of the State of California respectfully requests that the President, Congress and the United States Department of Agriculture acknowledge the importance of the dairy industry nationwide as well as the unique aspects of the dairy industry region-by-region through:

1) Updating the federal dairy product price support program to reflect today's cost of production;

2) Implementing fair tariffs on unregulated imported dairy solids;

3) Mandating greater market transparency.

4) Establishing a milk inventory management program.

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.