Agriculture Committee Testimony

July 28, 2009
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U.S. Dairy Export Council

Mr. Chairman, Ranking Member and Members of the Committee: Thank you for the opportunity to testify on the very serious situation facing our industry's ability to develop export markets and to present our recommendations for how to help improve these circumstances. My name is Tom Suber and I am the president of the U.S. Dairy Export Council. The U.S. Dairy Export Council (USDEC) is a non-profit, independent membership organization that represents the export trade interests of U.S. milk producers, proprietary processors, dairy cooperatives, and export traders.

The Council's mission is to increase the volume and value of U.S. dairy product exports. Our programs are jointly funded through the national check-off by dairy farmers, with matching funds from the U.S. Department of Agriculture/Foreign Agricultural Service (USDA-FAS) and from industry members. The programs cover a wide range of activities, but stop short of actually selling or subsidizing any dairy products.

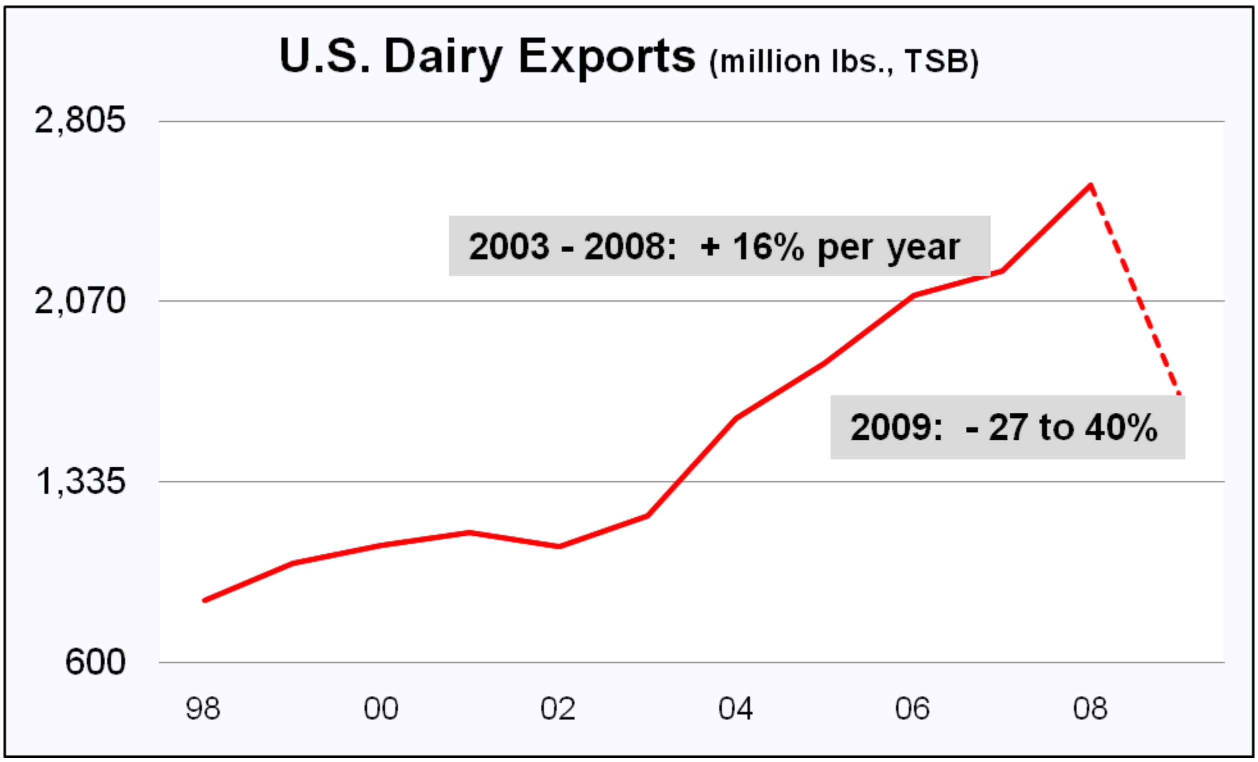
Both my preparation for testifying and my testimony today has been funded exclusively with non-checkoff membership dues of the U.S. Dairy Export Council. The time I have spent preparing my written testimony and my appearance today have not been funded with any checkoff dollars.

I'd like to begin by thanking this committee for the deep interest shown in the challenges currently facing the U.S. dairy industry and for the steps many members of Congress have supported to help address the situation such as full use of the Dairy Export Incentive Program (DEIP). We appreciate the concern about the grave circumstances facing many in our industry at the moment and we hope these hearings will help shed some light on various aspects of the challenges facing the dairy sector.

Global Dairy Market Dynamics and U.S. Export Situation

Over the past several years, U.S. dairy exports expanded significantly, hitting new record highs several years in a row. Over the past 5 years, U.S. dairy exports grew from $1.5 billion in 2004 to a high-water mark of $3.8 billion in 2008. By calculations made by the National Milk Producers Federation (NMPF), the impact of commercial exports boosted producer prices by $1.69 per cwt in 2008, thereby contributing $3.6 billion directly to dairy producer bottom lines.

We ship a broad array of U.S. dairy products all around the world. Our number one market is our full NAFTA (North American Free Trade Agreement) partner Mexico, a market where we have substantially benefitted from the full elimination of dairy tariffs and quotas. We also ship considerable amounts of product to Canada (despite the lack of virtually any NAFTA benefits for U.S. dairy exports there), Southeast Asia, Japan, the Middle East and China. Our most competitive products have been those products such as whey proteins and lactose for which global market distortions—high tariffs and quotas, export subsidies and domestic support —are lowest. However, we also have seen strong increases over the last five years in our exports of nonfat dry milk (NDM) and cheeses, in addition to other dairy products. The chart below illustrates this robust growth in U.S. dairy exports over the past several years on a total milk solids basis.



This growth did not simply happen overnight nor was it just blind luck. In fact, a portion of this success was inevitable since it was based on an immutable trend that the rising middle classes in emerging markets will use their increasing disposable incomes to add animal proteins to their diets. In both traditional and non-traditional dairy consuming countries, the rising incomes of the 1990s and this decade brought tens of millions of new consumers into various good-tasting and nutritious dairy food categories. The influence of rising incomes was accelerated by increasingly westernized diets in the food service sector, improved cold chain infrastructures and the continuing removal of distorting trade practices with the GATT Uruguay Round, then NAFTA and other FTAs.

It was clear to the farmer leaders of Dairy Management Inc. when they founded USDEC in 1995 that these trends would inevitably lead to a favorable change in global dairy trade for the United States. Traditional suppliers from Europe, Australia and New Zealand would simply not be able to keep up with the demands of new dairy consumers. Consequently, the United States, as the world's largest cow milk producer with a high quality, mid-tier cost base, was well-positioned.

Yet, it fell to USDEC to work with our industry—including farmer-owned cooperatives, proprietary firms and trading companies—to capitalize on this opportunity. In short, we sought to maximize the upside and minimize the downside that underlying economic and trade circumstances would permit. Therefore, USDEC focused on carefully-planned programs that integrated efforts to increase sales by helping members resolve constraints based on information, commercial, trade policy and regulatory factors.

The steady increases in U.S. dairy exports over the last five years underscored the importance of this unified national strategy. As supply became strained either from temporary issues such as weather or currency value or from long-term trends cited earlier, U.S. dairy farmers had the capacity and the will to quickly expand production in response to marketplace signals.

From 2003 to 2008, this was illustrated by two benchmarks. First, during this time, we exported almost one out of every three new pounds of milk we produced. Second, U.S. dairy exports as a percent of total production went from 5.7 percent to 10.8 percent. Also notable is that the DEIP program remained dormant during these years, as were massive EU export subsidies.

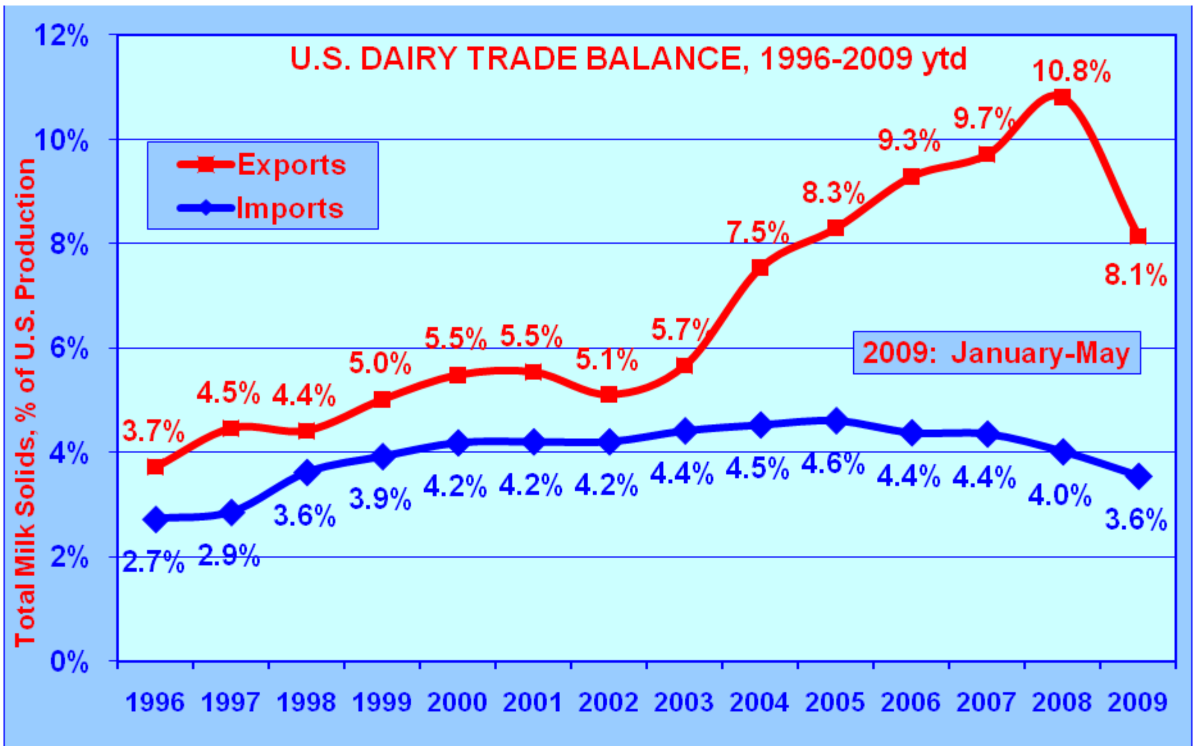
The 2007-2008 drought in New Zealand accelerated this gradual tightening of supply into an acute pinch, driving global dairy prices to record levels. Matched with a run-up of commodities such as oil and other food and feed products, net consumer incomes in important emerging markets began to erode. Then, just as high prices began to cap demand in early 2008, the global economic and financial crisis hit in the third quarter of 2008.

With these multiple factors, combined with the United States buying fewer goods from overseas, constrained or absent credit and trade financing, rising unemployment abroad and the dairy food scare brought on by China's melamine scandal, dairy demand simply crashed. During this same 2007-2008 time frame, record high milk prices worldwide fueled expanded milk production at the farm level. Oceania and European suppliers boosted production, as did supplemental global suppliers from South America and China.

Despite the crash in demand, these new supplies from various sources could not simply be turned off, resulting in a build-up of huge inventories, both private and public, for the first time in two years. World dairy prices ended the year down significantly from where they started. Export prices for milk powder, cheese and butter fell 40 to 60 percent in 2008, with the majority of the declines occurring in the second half. If this had been a more typical commodity cycle, we would surely have seen some weakening of demand such as that experienced in mid-2008. But the velocity and magnitude of the economic deterioration pushed the global market down far deeper than anyone expected.

The soft global markets have resulted in declining U.S. dairy exports in 2009. From January through May, the value of U.S. dairy shipments was $855 million, down 52 percent from last year's record pace, according to U.S. Department of Agriculture/Foreign Agricultural Service data released July 10. In the first five months of the year, exports represented 8.1 percent of U.S. milk production as measured on a total solids basis. This figure is down from 10.8 percent of production in 2008 and the lowest percentage since 2004.

The chart below depicts this trend line of exports as a percentage of total U.S. milk production through May 2009 (the most recent month for which data is currently available). For comparison, it also shows imports as a percentage of total U.S. milk production over the same time period. Both are calculated on a total milk solids basis.



A 3 percent change in the size of the market for milk that American dairy farmers produce may sound small. However, relatively small changes in total volume of milk production can result in huge changes in price as we've seen play out throughout this year.

Much of the decline in 2009 volumes comes from a drop-off in overseas sales of nonfat dry milk/skim milk powder (NDM/SMP), the largest U.S. dairy export commodity by volume and value. Exports from January through May were 195.2 million lbs., down 53 percent. Some exporters, however, have maintained shipments in lieu of selling to the Commodity Credit Corporation (CCC) by creating a standardized protein skim milk powder that is more desirable than our conventional NDM.

Cheese exports, which reached record-high volumes last year, were off 30 percent at 90.4 million lbs. for January to May 2009. However, based on good penetration and support from USDEC, U.S. exporters still are increasing sales to Mexico. As the largest overseas market for U.S. cheese, Mexico still gained 15 percent in the first five months of the year. Overall butterfat shipments for the same time period (January to May 2009) were just 18.6 million lbs., down 80 percent. Again, sales to Mexico were higher (+51 percent) as exporters focused on one of their core markets. I would be remiss not to mention the important role that the voluntary, producer-funded Cooperatives Working Together (CWT) export assistance plan. The strategic bonuses CWT has offered to participating members for exports to particular markets have helped support continued butterfat sales in particular as participants have shipped product in the early months of 2009 for which bonuses were granted in late 2008.

Exports of dairy ingredients like whey and lactose have held up well in 2009. Shipments of dry whey in the first five months of the year were 186.0 million lbs., up 15 percent from last year. Exports of higher-value whey protein isolates were up 51 percent, to 14.7 million lbs., while sales of whey protein concentrates were down 17 percent, to 105.4 million lbs. Overall, whey protein exports to key markets China and Mexico were higher, while shipments to South America and Oceania slackened. Exports of lactose were 182.0 million lbs., up 1 percent from January through May.

Dispelling Misconceptions

As an organization dedicated to trade and the promotion of U.S. dairy products overseas, USDEC would like to highlight some factors that it believes have contributed to current market pressures and proposals to avoid another crisis. We would like to take this opportunity to comment on a few of them in order to set the record straight on these trade-related issues.

- Imports: One charge repeated by some is the misconception that a surge in dairy imports has created or at least dramatically exacerbated the situation facing the dairy producer community. In a crisis such as we are currently experiencing, any imports can be damaging. Yet, in fact, we have not seen a significant surge in imported dairy products into the United States. In fact, on a total milk solids basis in 2009, year-to-date imports of dairy products are actually down compared to recent years. As I have stated above, the crux of the problem facing our industry is the swift and steep drop in global demand for our products, not an influx of foreign dairy products into the U.S. market.

- Isolationism: As supply management program ideas have begun to circulate, many have argued that isolationism would solve this crisis. The goal is seemingly to create a fully closed market like Canada’s. However, by aiming to address this aspect, we would likely create even more complications. It is virtually impossible to forecast market twists and turns accurately enough to match production with domestic and export demand. Therefore, overwhelmingly likely decisions by a so-called Supply Management Board would tend towards undersupply in order to keep farm incomes on the high side. The consequence would be steadily rising imports in reaction to prices much higher than those that exist globally, which would steadily ratchet down our domestic production. In short, we would steadily shrink as an industry.

- In addition, building a supply management system replicating Canada's would mean substantially raising our tariff walls, thus requiring offsetting trade concessions to meet WTO obligations. We also would face substantial problems selling exports beyond DEIP, since the WTO ruled out the use of a two-tier pricing system in a case that the United States itself brought—and USDEC strongly supported—against Canada in 1999.

Although some may argue that our industry is better off abandoning the export market, USDEC would like to take the opportunity to remind this committee that in 2009 to date, we have still exported approximately 8 percent of U.S. milk production and that this swing in the demand for only 3 percent of our total milk production has been one of the most significant factors leading to the current market situation. If we were tasked with somehow finding swift alternate uses for approximately 11 percent of U.S. milk production rather than simply 3 percent, the crisis would be even deeper and more protracted.

Whatever the declines in global markets, it is clear that processors and producers have come to rely upon exports as fundamental to the health and growth of the industry. We're far removed from the 1990s, when the value posed by a vibrant export market was simply theoretical, and the low levels of exports that existed were mostly facilitated by government programs. Now, a forced retrenchment will hurt most everyone in the supply chain.

Expectations for the Future

Entering the second half of 2009, recovery in global dairy demand remains elusive, leaving expectations for soft commodity markets for the balance of the year and into 2010. Global economic activity is still almost universally down over recent years. Developed countries remain in a recession that has lasted more than a year, still struggling with a credit crisis that has sapped normal commercial activity, while substantially increasing unemployment. These factors and others have resulted in sharply less demand for dairy products in emerging markets such as China, Southeast Asia and Latin America, where we saw much of the growth of the past five years.

Ultimately, the return of consumer demand will only come with the restoration of economic growth. Some early signs of recovery are emerging, albeit slowly. For instance, the International Monetary Fund (IMF) believes the global economy is beginning to pull out of recession, though full recovery is expected to be sluggish. Leading lenders such as Rabobank International have cautioned however that a build-up of inventories could forestall a speedy price rebound in the dairy sector. The more product stored in U.S. and European government warehouses or in private storage in Oceania, the longer depressed prices will persist. Thus, commitment of stocks to useful purposes such as domestic and international feeding programs is important in order to help shorten the current situation.

In the medium and long-term, however, virtually all forecasts foresee a return to dairy demand growth that exceeds the supply capabilities of lower cost exporters such as New Zealand, Australia, Uruguay and Argentina. Consequently, prices would increase to levels necessary to draw additional exportable supply from the next tier of producers. The United States is among the producers well positioned with the capability to profitably respond to this demand and provide additional exportable supplies to the international market. Because of this, USDEC is continuing to make the investments needed in overseas programs and relationships to pave the way towards that opportunity.

Recommended Government Actions

Congress and the Administration could pursue a number of measures that USDEC believes would help us maintain and improve our global competitiveness and permit us to more rapidly regain export markets as economies improve. Exports have already been shown to dramatically benefit farmer income; we cannot afford to ignore this part of the equation so critical to overall supply/demand balance of the U.S. dairy market. Some of these suggestions are short-term solutions such as full use of the DEIP. Others, such as passage of beneficial trade agreements, would help provide the medium to long-term growth our industry needs to continue to compete in the global market.

- We should swiftly move towards approving pending Free Trade Agreements (FTAs) with Panama and Colombia and, especially, South Korea. These agreements would remove barriers to our products and would either provide us with an edge over our competitors or at least allow us to remain on more even footing as many of these trading partners pursue FTAs with other important exporters. We recognize that the Administration and many members of Congress believe that some work is needed to address issues of concern they have regarding each of the FTAs; however, we urge that this work be done with the degree of urgency befitting such important international agreements.
    - We would caution, however, against the pursuit of agreements that offer no prospect for a balanced outcome such as would be the case under a Trans-Pacific Partnership FTA, if dairy trade between the United States and New Zealand were included. There are very strong anti-competitive concerns USDEC has with the near-monopolistic structure of the New Zealand dairy industry. Given such concerns, our members have advocated for the full exclusion of U.S.-New Zealand dairy trade, should the TPP FTA move forward as currently envisioned.

- At the same time that we pursue genuinely beneficial bilateral agreements, we must not take our eyes off the bigger prize—a successful multilateral deal. We urge the Administration to continue to aggressively pursue an ambitious Doha Round agenda, which would prevent the backsliding that we are now witnessing on export subsidies and market access, particularly in developed countries that have become such a serious concern this year. We need to have a balanced market access package that calls on those with the steepest tariff barriers to do the most and does not undermine the access secured in key developing markets in the Uruguay Round. Additionally, the swift and full elimination of export subsidies is a particularly important aspect of the overall Round, as we've seen the impact this year's reactivation of the EU's massive subsidies has had on global markets.

- So long as the EU continues to employ its export subsidies, however, it is essential for the United States to use the tools available to it as well. We call on Congress to urge the Administration to maximize its use of the DEIP. This program is small in comparison with what commercial trade can drive during more typical market conditions (150 million pounds of NDM annually permitted under DEIP versus an average of 660 million pounds of NDM exports annually between 2004 and 2008). Despite its relatively small size, in times like these it is an important way to help stimulate export demand for U.S. products in a global economy currently plagued by ever-rising EU export subsidies.

    - DEIP also helps counter the continuing practice by New Zealand to clear its inventories at virtually any price due to its need to export 95 percent of its production. New Zealand has now become the world price maker with its recent, almost panicked selling, which will resume upon the start of its production season in August. Full use of DEIP can help our exporters keep a foothold in key markets to help better enable them to maintain relationships that have been cultivated over the years but are facing heavy strain due to market dynamics this year.

- In a similar vein, we ask that Congress maintain funding for the Market Access Program (MAP) and the Foreign Market Development (FMD) program at their full Farm Bill authorization levels of $200 million and $35 million, respectively. We also urge Congress to direct the Administration not to make changes to the current eligibility parameters for the program. Wide consensus exists that they contribute to the great success of the program and overall U.S. agricultural exports. MAP and FMD are excellent examples of a successful industry-government partnership that can directly benefit producer incomes, as the dairy industry has seen over the past five years. USDEC has participated in these programs for several years now and has used the funding to help grow demand for U.S. dairy products abroad and cultivate receptiveness to supplies from the United States—until recently not one of the major dairy exporters to the world.

- The other critical part of the export support equation is the expertise the FAS team, both in Washington and many of the overseas offices, brings to bear on the many challenges facing our exporters. These range from the close cooperation between FAS and the U.S. Trade Representative's Office (USTR) on free trade agreements (FTAs) and World Trade Organization (WTO) issues, to resolution of important sanitary/phytosanitary (SPS) and technical barriers, to technical barriers to trade (TBT) challenges to addressing time-sensitive issues when product is detained in port. The knowledge of FAS and its dedication to helping facilitate the flow of U.S. exports and influencing the policy dynamics disadvantaging our products is absolutely critical. We urge Congress to fully support FAS's core mission of promoting U.S. agricultural exports by providing adequate funding to achieve this goal.

- As our hard-working FAS and USTR staff go about trying to make our trading partners adhere to their commitments, however, it is equally critical that the United States live up to the trade commitments it has made by adhering to our trade agreements and basing technical trade-related decisions on sound science. Very simply, how can we demand others abide by their deals when we simply refuse to do the same by inventing specious justifications?

    - One particularly important issue is our cross-border trucking obligations with Mexico under NAFTA. The United States was found several years ago to be in violation of NAFTA by refusing to allow cross-border trucking with Mexico, despite our ability to require Mexican trucks to adhere to the very same requirements U.S. trucks face while on American roads. In the spring of this year, Mexico finally retaliated against the United States for this trade violation, putting at risk $2.4 billion worth of trade. As Mexico is by far our number 1 dairy export market, we believe it is essential that the United States adhere to its trading obligations under NAFTA.

    - There are additional examples of a more technical nature as well that have given USDEC cause for concern. The health and safety of America's consumers has always been a major focus of America's dairy farmers and processors. However, it is vital that in making decisions regarding imported food products and various SPS trade issues, we apply the same rigorous adherence to sound science and uniform standards that we expect our trading partners to apply in their own countries. Safe food must be paramount, but we must let science run its course and then rely upon the results, rather than prejudging the outcome of that technical assessment.

- Finally, I would leave this committee with a request that it take an interest in a forthcoming report by the Innovation Center (IC) on U.S. Dairy on the impact on and consequences of the dairy industry's increasing globalization. Staffed and supported by Dairy Management, Inc., the Innovation Center provides an unprecedented, high-level forum where top leaders from dairy farm groups, processors, co-operatives and trade associations can review major structural constraints to industry growth and prosperity. Work outcomes then represent an integrated, pre-competitive and collaborative set of analytical, policy, regulatory and market development programs across a range of issues.

- In March, an Innovation Center task force retained an experienced management consulting firm to profile the present and future state of the global dairy trade, the competitive position of the U.S. industry, and a prospective set of integrated programs that could improve our ability to accommodate these changes. The task force is close to concluding its work on this “white paper” analysis. The report of its preliminary findings earlier this month to the IC board created considerable interest in its insights. The analysis showed a virtual certainty that, with a return to global economic stability, dairy’s global supply/demand dynamics (as reflected in my earlier comments), would create a sizeable latent demand gap that the United States was well positioned to fulfill. Yet, the analysis also showed that this window of opportunity to grow both our internal and external markets against global competitors was finite. Success depends on making the right strategic choices.

- Presented with choices ranging from “Fortress USA” to the status quo to moving towards a consistent, global exporter role, the Innovation Center board asked the task force primarily to focus its final recommendations on prospective programs to pursue the latter path. Once the Innovation Center board has reviewed and decided upon its work programs, we would welcome the opportunity to brief interested members of this Committee on their objectives.

Thank you for the opportunity to provide comments to this Committee on such an important topic. USDEC appreciates the time and attention members of this Committee have devoted to the concerns facing many in the dairy industry.