

Statement of Dr. Scott Brown
Before the U.S. House of Representatives Committee on Agriculture
Rural Economic Outlook: Setting the Stage for the Next Farm Bill

February 15, 2017

Chairman Conaway, Ranking Member Peterson and Members of the Committee, thank you for the opportunity to testify regarding the rural economic outlook for dairy and livestock producers in this country. I am the state agricultural extension economist at the University of Missouri and for the last three decades have worked extensively on federal policy issues with a detailed focus on dairy policy issues.

The rural economy in Missouri has been changing quickly although the change has not been spread evenly across all parts of rural Missouri. The Agricultural Resource Management Survey (ARMS) conducted by USDA shows that the debt/asset ratio of all Missouri farms increased by only 1.8 percent from 2012 to 2015. However, Missouri producers in the 35 to 44-year-old age group saw a debt/asset ratio that nearly doubled from 14.5 percent to 28.8 over the same period.

Lower cattle, milk and hog prices resulted in livestock industries facing increased financial headwinds in 2016 which will likely continue into 2017. In late 2016, feeder cattle prices were less than 50 percent of their value relative to early 2015. They will likely continue to move lower in 2017. At this point, the only livestock industry anticipating higher prices is the dairy industry as tighter global markets suggest milk prices can move higher from recent lows. A bright spot for the livestock industries is that feed costs are lower than experienced just a few years ago, as the Economic Research Service of the United States Department of Agriculture (USDA-ERS) shows purchased feed expenses reached \$63.7 billion in 2014 but are projected to decline to \$57.9 billion in 2017.

The dairy industry faced much lower milk prices in 2016. After reaching a record level of over \$24 per hundredweight in 2014, the milk price declined to almost \$16 per hundredweight in 2016. Two factors drove this decline in milk prices.

First, the value of U.S. dairy product exports declined from a 2014 record of \$9.5 billion to \$7.1 billion in 2016. A stronger U.S. dollar and growing international milk supplies hindered U.S. dairy exports. U.S. dairy product exports have been slow to recover although reduced global milk supplies

should help strengthen U.S. exports. Burdensome intervention stocks in the European Union remains one cautionary issue to stronger international dairy product prices in 2017.

Second, despite a tough economic environment for dairy producers in 2016, milk production expanded for the 7th consecutive year. U.S. dairy cow inventory increased by 48 thousand head during 2016 despite the financial headwinds experienced by the industry. The growth in dairy cow inventories and milk supplies highlights that the lower milk prices seen in 2016 had differing effects within the industry as California dairy cow numbers declined by 9 thousand head while Texas expanded by 35 thousand head.

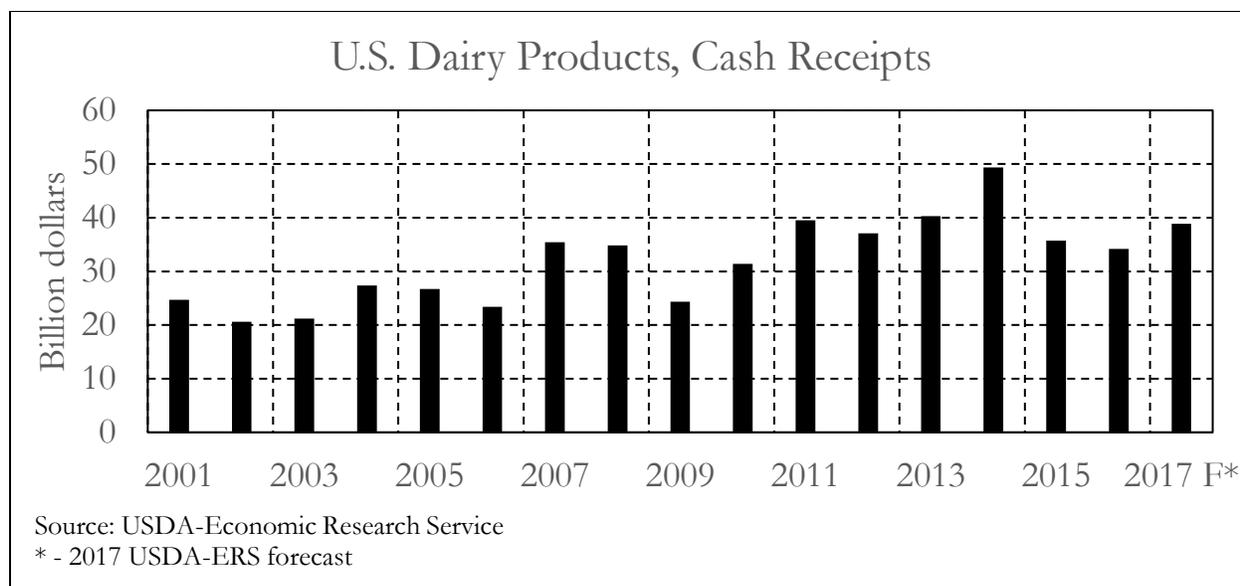
It has become increasingly difficult to reduce U.S. milk supplies, even when milk returns suggest contraction is needed. During the 1980s and 1990s, there were more dairy farmers with relatively higher production costs that would exit the industry during tough economic times. By the 2000s, the remaining operations tend to have larger fixed costs, which makes them less responsive to current financial conditions.

Historical data on U.S. milk production highlights past difficulties in reducing milk supplies when producer returns are low. Since 2000, annual milk production has only declined in 2001 and 2009. Milk production even expanded during the drought-induced record feed prices of 2012-2013. In comparison, annual milk production fell 5 times over the 1986 to 1999 period.

The 2016 economic downturn that the dairy industry faced has resulted in many looking for alternatives to the dairy safety net program contained in the 2014 farm bill. There is growing concern that the Margin Protection Program (MPP) did not provide a strong enough safety net for U.S. dairy producers in 2016.

Before examining detailed MPP features, it is important to understand the large task of building a solid safety net program with a tight federal budget. It is extremely difficult to construct a stronger safety net program for dairy farmers while reducing federal spending remains a priority.

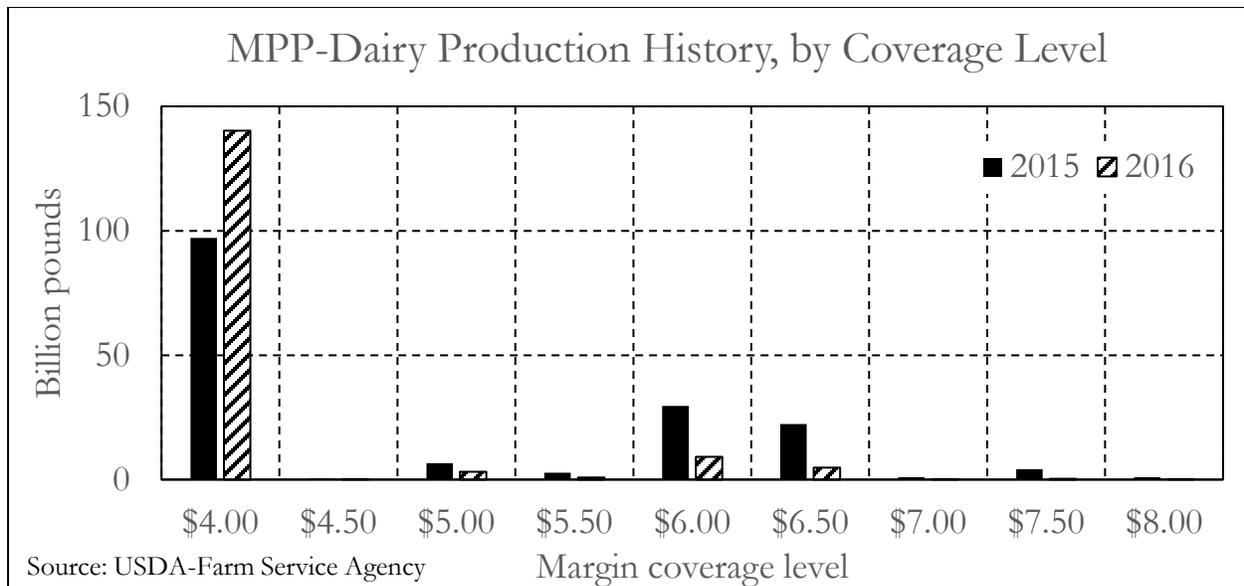
Dairy cash receipts have remained volatile over the past several years. In the economic disaster of 2009, they totaled only \$24.3 billion. By 2014 they had swelled to \$49.3 billion. Dairy cash receipts retreated to \$34.2 billion in 2016. It is instructive to note that 2016 cash receipts remained \$10 billion above the 2009 level.



The Congressional Budget Office currently estimates annual dairy CCC expenditures at \$79 million over the FY2017 to FY2027 period. Identifying a safety net program for dairy producers that can moderate the billions of dollars change in dairy cash receipts that have occurred in the last few years and yet only show an average cost of \$79 million to the federal government is a large challenge.

There is a high correlation between the level of government expenditures for the dairy industry safety net and the effectiveness of the safety net. Changes to the MPP or for that matter any other alternative that may be debated as the 2018 farm bill comes into focus will likely result in a more effective safety net only if the estimated cost of the program rises. It is important to remember that dairy farmers will always remain in a better financial situation when market conditions result in little to no government spending, as a safety net program hardly ever completely offsets lower market returns.

We are entering our third full year of the MPP. The level of dairy farmer participation in the higher margin coverage levels has continually fallen as premium costs have exceeded anticipated MPP payments. In 2016, 140 billion pounds of production history or about two thirds of U.S. milk production was enrolled in only the catastrophic \$4 level of coverage. That catastrophic level of coverage is a pretty low safety net with margins not falling below that level since 2009. No region of the country has shown an appetite for much buy-up beyond the \$4 level. 2017 MPP enrollment data will show even more production history has shifted to the \$4 coverage level as many producers are not willing to buy up coverage given the low probability of payments.



The state by state data on MPP participation shows that all states have little to no buy up coverage at this point. The \$4 catastrophic coverage that costs a producer \$100 annually does show some variability when looking at signup on a state basis. Two of the larger western states, California and Idaho, have more than 80 percent of their 2016 milk production levels covered under the \$4 level while upper midwest states like Minnesota and Wisconsin have about 60 percent of 2016 milk production covered under the \$4 level. Many states in the northeast and southeast areas of the U.S. are like the upper midwest in terms of the amount of milk signed up at the \$4 level.

MPP participation has been much lower than many estimated when the program became law in early 2014. When MPP was being debated before the 2014 farm bill was finished, many assumed that 70 percent of milk production would be signed up for \$6.50 coverage. The 2016 MPP data shows that slightly more than 2 percent of 2016 milk production was signed up for the program at the \$6.50 level. This data and experience should inform that estimates of sign up under similar programs must be reevaluated carefully and lowered relative to original estimates.

The MPP experience has been very different than many projected during the debate on the program, especially the level of government spending. In the largest bi-monthly payment period since enactment of MPP which occurred in May/June 2016 payments totaled less than \$12 million. CBO estimated spending under the MPP as passed in the Agricultural Act of 2014 at \$912 million over the FY14 to FY23 period. Other estimates of government outlays on the program topped \$2.5 billion over even shorter timeframes.

In my original analysis, the stochastic results suggested that at a \$6.50 margin level nearly 80 percent of the time there would not be a MPP payment. The remaining 20 percent of stochastic outcomes where payments occurred they were large enough to offset the 80 percent of the time of paying the premium without a payment. Historical examination would suggest similar findings of payments that don't occur often but when they do they offset the longer periods of time with no payments. It would be important that producers are signed up at the "right" time to make the MPP work for producers over the long term.

In addition to the experience that participation in the MPP has been much less than expected, feed costs have moved much lower than estimated when the program was first enacted into law in 2014. The CBO baseline as well as other long-term baselines had projected corn prices much higher than are currently forecast. The 2013 CBO baseline had corn prices that averaged \$4.59 per bushel over the 2013 to 2023 marketing years. The most recent CBO baseline has lowered the average corn price estimate over the 2017 to 2027 marketing years to \$3.79 per bushel. Other feed costs have also moved lower than originally estimated.

All else equal, the decline in feed costs should reduce MPP program costs and reduce the expected cost of alternative programs driven in part by feed cost levels. It is interesting that this decline in corn prices and feed costs in the different baselines provides nearly an offset on average to the policy proposal to raise the feed coefficients back to the levels first set in 2012.

The 2016 MPP experience left many dairy farmers disenchanted with MPP. The reduction in feed costs as represented by national corn, soybean meal and alfalfa prices resulted in the MPP margin falling far less than the decline in national milk prices. The MPP margin seemed out of sync relative to many producers who saw their financial situation erode much faster than the MPP margin. In some cases weather played a role in the disconnect while in other cases farmers that grew a significant portion of their feed inputs did not benefit from the decline in feed costs suggested by the declines in market prices for corn, soybean meal and alfalfa prices.

USDA-ERS estimates that 63 percent of Wisconsin dairy farmers' feed costs come from homegrown harvested feed compared to 26 percent in California. Dairy producers that buy a majority of their dairy feed may be in a better financial position today than those that grow more of their feedstuffs, as the total corn production cost reported by ERS has changed little over the 2013

to 2016 crop seasons. USDA-ERS reported 2013 total corn production costs at \$676.45 per acre while they estimate 2016 at \$672.39 per acre.

An adequate safety net for dairy farmers remains the goal for federal dairy policy. The reduction in financial risk and the stronger safety net afforded dairy farmers under alternative dairy policies must be absorbed by others. The federal government remains the largest source of producer risk reduction through government spending on farm programs. Given the inelastic nature of supply and demand of dairy products, the cost of a dairy program can go from zero to billions of dollars quickly. Understanding the most critical risks to cover for dairy farmers today is important. One only has to look back to years like 2009 to understand that a program like MPP can cost billions of dollars. Although the likelihood of 2009 occurring in the future may be low, it makes the scoring of these kinds of policy options extremely difficult. Finding ways to spread risk across federal policy and market risk tools may be the balance needed to provide a better safety net for producers.

The MPP was a major change in dairy policy relative to the past safety net provided to the dairy industry. The move to a policy providing margin risk management from one that provided a floor on milk prices has required moving from an attitude of program return maximization to risk management. More work is needed to help producers think through the risk management aspect of the MPP. MPP participation has moved to the lower levels of margin coverage when at times producers may be better served to participate at higher levels.

A balance must be struck in setting parameters of federal dairy policy. We have had experience with dairy programs that provided too much support to the industry and resulted in large milk surpluses and chronically low milk prices or large government expenditures. No one in the dairy industry liked these periods. However, setting support too low means it may never trigger in those times that it is most needed. This tradeoff will always require modifications as future farm bills are debated and passed.

Mr. Chairman, thank you for the opportunity to discuss the many issues facing the livestock and dairy industries today and I am looking forward to working with the Committee on finding solutions that provide a better safety net for dairy farmers that can be embraced by all dairy market participants as the 2018 farm bill process unfolds.