U.S. House of Representatives
Committee on Agriculture
Subcommittee on Livestock and Horticulture
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Testimony of Milk Producers Council
Given by
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Mr. Chairman and members of the committee, my name is Fred A. Douma and I am a dairy producer operating in San Joaquin County, California. I am testifying today on behalf of Milk Producers Council (MPC), which is a dairy producer trade association with members operating primarily in Southern and Central California. For the past two decades MPC has been consistent in evaluating and promoting federal dairy policy that conforms to the following four basic principles:

- Dairy producer income should come from the market
- Price should be the major factor in adjusting supply and demand
- Government should provide a safety net that supports the market price of dairy products, but does not encourage surplus production.
- Government should continue to enforce marketing orders that fairly allocate market dollars between producers and processors.

U.S. dairy policy over the past two decades has for the most part been consistent with these principles. In our opinion, these policies have served producers well. Prior to the 1981 farm bill, the 1977 farm bill utilized a policy of using the support program to actually enhance producer prices as opposed to simply using the support program as a market clearing safety net. The consequence of that policy was unprecedented milk surpluses. It took nearly a decade of difficult economic adjustments and a huge government cow buyout program before the milk supply and demand situation returned to more manageable levels. Hopefully we have learned from that experience.

Once the massive surpluses of the 1980's were dealt with, the farm bills of the 1990's dealt more with modernizing and fine-tuning the Federal Milk Marketing Order (FMMO) and the Milk Support Price program. While the 1995 farm bill intended to end the dairy support program in 1999, it has been extended because both the industry and the Congress realized that at the current price level of $9.90, the program was acting as the market clearing safety net that it was originally designed to be. Milk Producers Council's strongly supports the continuance of the Support Price Program at the current $9.90 level.

However, there are two problems with the current operation of the support price program that USDA has the authority to address, which we would like to bring to the attention of the committee.

The Effective Operation of the Support Purchase Program:
While Congress specifically establishes the support price, the details of the implementation of the program are left to USDA. During the year 2000, market prices for cheese in particular fell to a point where it was very important for the support program to kick in and provide a safety net. Unfortunately, while USDA did publish and was apparently willing to buy cheese at a price that would enable cheesemakers to pay at least the $9.90 support price to producers, in reality the market price fell far below USDA's published cheese price. As a result, the Federal Order price for milk used to make cheese fell to a totally unacceptable $8.57 per cwt. in November of 2000. In our view, had the support program worked as it should have, the producer price for milk used to make cheese would have stabilized at around the support price level of $9.90 per cwt. and that would have significantly minimized the anxiety that producers, particularly in the heavy cheese producing regions of the country felt in the waning months of 2000. Milk Producers Council would propose two remedies to this problem.

First, USDA should streamline and modernize its purchase rules so that the Commodity Credit Corporation (CCC) is able to clear the cheese market when a market collapse is imminent. Among the things the CCC needs to revise are product specifications, packaging specifications, and laboratory testing procedures and inspections. In addition, processing plants complained that the CCC was slow to pay for their purchases. USDA has already indicated that they are going to make revisions to these procedures. It would be helpful if the committee indicated to USDA the importance of making sure that the Support Program safety net works effectively.

Second, USDA should use the support purchase prices for butter, powder and cheese as the minimum market prices in the FMMO pricing formulas. Under the current FMMO formulas, dairy-manufacturing plants report on a weekly basis to USDA the prices they are receiving for butter, powder and cheese. USDA then sets the producer prices based on these market price reports. The formulas give manufacturers a fixed make allowance which remains constant regardless of the market price of the dairy commodity. In effect what this system does is allow manufacturers to almost fully transfer the market price risk to producers. If USDA were to floor the market prices in the FMMO formulas at the support purchase price levels, then manufacturers could not transfer to producers the negative results of the processors decision to sell dairy products on the market at prices below the support purchase prices.

The Level of Purchase Prices:
While Congress specifically set the support price at $9.90 per cwt. the decision about what the purchase prices of butter, powder and cheese are, to accomplish that outcome, is left to USDA. Over the past 18 months, the Commodity Credit Corporation has purchased over 600,000,000 pounds of Non Fat Dry Milk through the support program. This level of purchases is very troubling. The purpose of the support program is to be a market clearing safety net. When the CCC begins to purchase nearly one-half of all the NFDM produced in the US, then the program is in danger of triggering the kind of surpluses, at least of a particular product, which could hang over the industry for a long time and undermine the markets ability to recover. It is important to note that a decade

ago, when CCC butter purchases where high relative to NFDM purchases, USDA lowered the butter purchase price in a successful effort to stimulate market demand for butter. There are now those who argue that the purchase price of NFDM is too high. We see a lot of merit in that argument. It is our view that a modest adjustment in the butter/powder purchase prices now will allow NFDM to become more competitive in the market place thereby reducing government purchases and expenditures. This can be accomplished while still maintaining the $9.90 per cwt. support price.

Direct Payments to Dairy Producers

Three times during the last two years Congress has authorized direct payments to producers. While no one is in a position of turning down the money, Milk Producers Council is very troubled by the policy implications of these direct payments. We understand that most of the feed grain programs have historically included direct farmer payments. The low commodity prices of the past four years have necessitated increased payments by the government to help farmers get by. (It is important to note that because most dairy producers buy at least a portion of their feed inputs, low feed commodity prices are of significant benefit to dairy producers.) However, Milk Producers Council does not believe that any type of direct payment should be part of our national dairy policy. Therefore we are opposed to the cash deficiency payment program that is being proposed by National Milk Producers Federation (NMPF). In that proposal a target price of $11.08 per cwt. for milk used to make cheese is established and for every month that the market price does not reach that level, cash payments from the US taxpayer would flow to dairy producers whose milk is used to make cheese. This proposal has several flaws that make it bad dairy policy:

- Because this program would limit the impact of low market milk prices on producers, the market signals normally sent when milk is in a surplus condition would be muted. This fact would move US dairy policy further away from market orientation.

- With direct cash government payments taking the pressure of low milk prices off of producers, the incentive for cheese plants to raise the market price of cheese would be minimized further distorting market signals.

- Under current US feed grain policy, low feed costs to dairy farmers make a $11.08 target price profitable for many producers. Having the government guarantee that price would likely stimulate increases in production which would lead to significant milk surpluses.

- Government costs of the dairy program would dramatically increase, which could undermine political support for the legitimate functions of the US dairy program.

NMPF's own analysis of their proposal indicates that the cost of the deficiency payment program starts at $500 million per year and steadily escalates from there. Their analysis shows that the program stimulates increased production that contributes to continued milk surpluses that keep market prices for cheese low. This in turn causes the annual cost of the deficiency program to escalate about 20% per year. At no time in NMPF's own

analysis does supply and demand for cheese balance itself to a point where the deficiency payments would not be needed. To start out with a program, whose proponents own analysis show will cause dairy producers to become permanently addicted to government cash to survive, is policy that should be soundly rejected by Congress.

Over the past twenty years great progress has been made in bringing the overall milk supply/demand into fairly close balance. Dairy producers in 1998 and 1999 saw very good milk prices and enjoyed significant overall profitability. Not surprisingly, favorable economic times on the dairy farm led to milk production increases, those increases caused the milk price to decline, which sent the clear signal to the industry to adjust production. That adjustment took place during the past 15 months and milk prices are now beginning to recover. The market works and the dairy industry has the opportunity to again prosper because of the fundamental soundness of the policies that have been in place for the past two decades. Now is no time to make a radical change in those policies.

Other issues:

Over the past couple of years there has been a dramatic increase in the importation of a milk type ingredient called Milk Protein Concentrate (MPC) that can be used in many dairy products as a substitute for NFDM. While no doubt some of this rise in imports can be attributed to the higher protein concentration of MPC (over 40% protein) compared to NFDM (33% protein), for the most part according to a GAO study, the importation of this product was caused by a price advantage that was derived because MPC was not covered under the GATT dairy trading rules. The GAO report also discovered that much of the imported MPC, in reality is nothing more than a blend of NFDM (which does have trade restrictions) and some high protein additive. The sole purpose of this blended product is to get around the trade restrictions on NFDM. Milk Producers Council strongly supports efforts to bring Milk Protein Concentrate products under the overall umbrella of the dairy trade provisions of the GATT agreement.

The Uruguay Round of trade negotiations significantly opened access to the US dairy market. It also significantly limited the amount of product that countries could subsidize for export. Those reductions do appear to have had some positive impact on world market prices for some dairy commodities, however the European Union is still allowed to subsidize, in absolute numbers, significantly more product than the US. Milk Producers Council supports the continuation of the Dairy Export Incentive Program until such time as all subsidized exports are forbidden by trade agreements.

Milk Producers Council appreciates the opportunity to testify today. We look forward to actively participating with the Committee in the development of the next farm bill. We are convinced that sound, market oriented dairy policy is in the best interests of America's dairy producers, processors and consumers.