

Testimony of Howard Straub, Jr.
Michigan dairy producer
Triple H Farms - 3800 Essex Center Rd. - St. Johns, Michigan 48879 - Ph: 989-224-3112
on behalf of myself and the Dairy Policy Action Coalition
for the United States Senate Committee on Agriculture, Nutrition & Forestry
May 31, 2011

Introduction:

I would like to thank the Honorable Chair Debbie Stabenow for having this Senate Agriculture Committee field hearing on “*Opportunities for Growth: Michigan and the 2012 Farm Bill.*”

My name is Howard Straub. My wife Mary Jo and I have a milking herd of around 100 dairy cows on 250 acres at our grazing-based Triple H Farms near St. Johns, Michigan. Three of our children also have dairy herds of their own in Michigan and Ohio. In addition to serving on the Grazing Lands Conservation Institute (GLCI) Steering Committee, the American Forage and Grasslands Council, the Michigan Forage Council and the Michigan Food & Farming Systems (MIFFS) Council, we’ve partnered with the U.S. Department of Agriculture Natural Resources Conservation Service (USDA NRCS) and Michigan State University to advance research and outreach in our state and across the nation. We currently ship our milk through membership in the Michigan Milk Producers Association. Recently, I have also become involved as an ad hoc member of the Dairy Policy Action Coalition (DPAC) board, which formed in November 2009 as a grassroots coalition of dairy producers actively participating in the policies and issues affecting milk pricing.

Like most dairy farmers, not only is dairy farming my occupation and business, but also a way of life. The vast number of skills needed to be a dairy producer today include being an expert in animal husbandry, agronomy, genetics, a mechanic and an accountant. Dairy farmers must also acquire the knowledge needed for the regulations we farm under today to insure we are farming in an environmentally responsible way and producing safe and wholesome food for the consuming public.

Dairy farmers across the U.S., regardless of size, suffered significant losses in net farm income and equity during 2009, and into 2010, because of low milk prices and high input costs. However, federal dairy policy should not be looked at as simply a way to avoid what happened in 2009. **Instead, dairy policies in the next Farm Bill should position U.S. dairy producers – and future generations – for the global realities of the 21st Century.**

Since at least 2006, there have been countless forums and many opinions on how to improve our federal dairy policy and make it a better system. The suggestions we hear today from our dairy leaders range from supply management and export discounts paid by milk check deductions, to pricing formula changes and new safety nets based on “national margin” insurance.” The industry is divided on many of these issues, and we know the frustration this creates in Congress.

But there are some areas where farmers agree, and where we can find common ground for a brighter future.

As a nationwide coalition of grassroots dairy producers, DPAC views supply management as the idea that most divides dairymen and pits region against region.

Having participated in other coalitions to evaluate different supply management proposals, DPAC does not endorse mandatory supply controls or penalties – including National Milk Producers Federation’s (NMPF) Dairy Market Stabilization Plan within its Foundation for the Future (FFTF) plan.

I agree with DPAC’s position. One reason I do not endorse such supply management or “stabilization” programs is because they are mandatory, nationalized and centralized, and I am concerned about putting that level of control on top of a federal pricing and marketing system that is already complex, cumbersome, lacks transparency, lacks good price discovery, and places 100% of the price risk on producers, while having policies in place that insulate other sectors of the supply-chain from the consequences of manufacturing decisions that are often based on federal programs and policies instead of being market-driven.

As dairy farmers, we do not want to give more power over our independent family dairy farm businesses to the system that is right now failing us, failing consumers of our products, and failing to position U.S. dairy producers for a growing export market.

I. Improve Market Transparency & Price Discovery

Today’s milk pricing system is a bit like the “wizard behind the curtain”... pulling this lever and that lever to keep the people of “Oz” from seeing what’s really on the other side: What is the true value of our product in the marketplace? And how is the value of so many dairy products being passed back through the system to the farm?

Dairy farmers are united on this one major point: Pull away the curtain and introduce price discovery that is simple and transparent so we can be fully informed participants in the market for our products.

We have little say in how our prices are fixed by the federal orders. When mistakes are made, we have no redress. For example: The misreported powder prices in 2006-07 cost dairy farmers a minimum of \$50 million. Another example is the current “make allowances” and “yield factors” in the product price formulas. The product price formulas that are used now to set our milk price helped transfer wealth from producers to processors just as we hit the world economic collapse.

The farmer’s share of the consumer’s dairy dollar (for all dairy products) has shrunk from 42% as recently as 2002 down to 27% in 2009-10, according to experts who testified at the USDA / DOJ workshop in Madison, Wisconsin in June 2010. Meanwhile, milk has gone from a small margin product to a literal “cash cow” for the ever-larger supermarket chains that dominate the price squeeze back through the supply chain.

As dairy farmers, we do not have a problem with other supply chain sectors making good money. That's business. What we do have a problem with is the fact that we dairy farmers are pretty much kept in the dark about the value of our product and everyone keeps saying it is our own fault for producing too much of it... Yet they are happy to make a profit on every pound we make along the way, and not too happy about simplifying this pricing system or providing daily price and sales volumes reports so we can have transparency. Why?

Looking back at the industry's discussion of dairy policy from 2006 through the present, the issue that keeps rising to the top is the need for market transparency and improved price discovery. Current reporting (USDA-NASS Survey) does not consistently reflect broad supply and demand factors. Even the economists at the University of Wisconsin and other academics acknowledge this (below).

DPAC spent most of 2010 pushing for implementation of Section 1510 from the last Farm Bill, and it was an uphill battle even though Congress had already authorized it. Ultimately, electronic reporting was included in the Mandatory Livestock Reporting reauthorization bill last September, but the reporting is still weekly, not daily. Currently, the surplus cheese and butter markets on the Chicago Mercantile Exchange (CME) indirectly set our milk price even though less than half of one percent (0.4%) of cheese and less than two percent (1.8%) of butter are traded on the CME by very few buyers and sellers.

We need daily reporting of actual sales prices and volumes in this industry. And, perhaps even more importantly, we need to have reporting that is expanded to include more plants and more products.

The University of Wisconsin and FAPRI economists included this information in their 2010 dairy policy brief:

“Product price formulas (which are used to calculate the milk price) rely on wholesale prices for dairy products that are collected and reported by USDA’s National Agricultural Statistics Service (NASS). While reporting is mandatory, NASS only requires reporting of prices for spot market sales, which represent less than 20% of the butter production and less than 40% of the cheese production. Moreover, because prices for most butter and cheese transactions are pegged to the thinly-traded Chicago Mercantile Exchange (CME) markets, even spot market sales prices may not consistently reflect broad supply and demand conditions.”

This is a crucial statement. If NASS product prices do not consistently reflect broad supply and demand conditions, then the dairyman's milk price may not be accurate. This is because the CME drives the spot market sales, which NASS collects weekly. There is a 98% to 99% correlation between the CME spot “market” and the NASS Survey. The NASS Survey simply introduces a two to six week lag time.

The quarterly auditing provision contained in Section 1510 of the Dairy Title in the 2008 Farm Bill is also important for accuracy and to avoid or quickly amend any “misreported” prices. Other agriculture commodities and animal protein sectors have daily mandatory reporting.

Daily Electronic Reporting and Quarterly Auditing will:

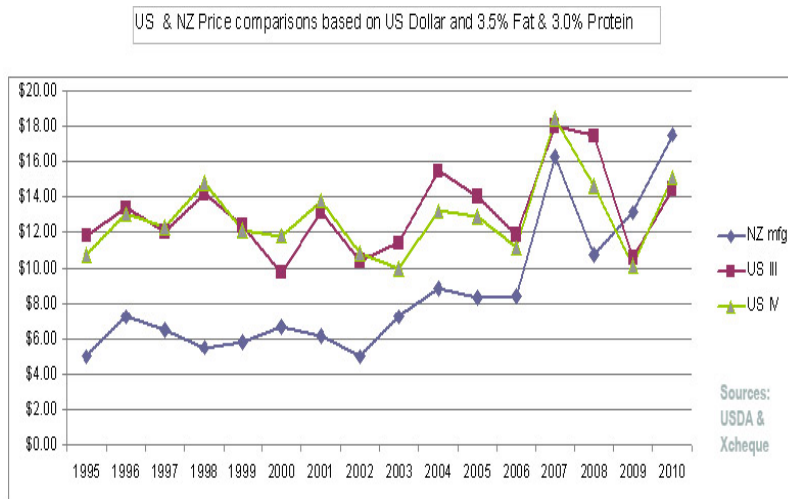
- Increase accountability to help restore producer trust;
- Reduce the influence of the thinly-traded and volatile CME on producer milk prices;
- Improve accuracy and timeliness;
- Reflect broad supply and demand conditions;
- Position dairy farmers better to manage their own risk and make good business decisions;
- Improve the milk price discovery process by providing more market information about the products made with milk; and
- Increase U.S. competitiveness at home and in the international markets.

II. End the Dairy Product Price Support Program (DPPSP) & Encourage Innovation

DPAC agrees with NMPF, and other groups on this point: The Dairy Product Price Support Program (DPPSP) should be eliminated in the upcoming Farm Bill.

- It stands in the way of U.S. dairy farmers benefiting from dairy product innovation and world markets because it positions the U.S. as the last in / first out supplier.
- No other U.S. agricultural commodity still has these constraints when dealing with global markets.
- Instead of relying on government support purchases, the U.S. dairy industry needs policies that position us as a consistent supplier to the world market.

We can clearly see that the DPPSP, set at a milk price equivalent of \$9.90/cwt, is too low to help dairy farmers in a time of economic collapse. And, when those products are purchased and stored by the federal government, they keep a lid on the ability of the market to recover and advance.



We saw proof of this in 2009: Other nations – like New Zealand – saw their dairy product prices rebound after about six months, while the U.S. price remained low for 18 to 20 months. The problem in 2009 wasn't the volatility, it was how long the price flatlined at such a low level.

The U.S. essentially served as the “balancer” of the world’s supply of milk to the detriment

of our own producers because we did not compete and clear product. We sold to the government warehouse.

Under the DPPSP, the federal government purchased 276,156,841 pounds of nonfat dry milk (NFDM) in addition to butter purchases from Oct. 1, 2008 through Oct. 1, 2009. Most of this powder was purchased from Oct. 1, 2008 through April 2009 when U.S. imports of milk protein concentrates (MPC's) were at record levels in December 2008 through March 2009 before leveling off in June of 2009. After New Zealand's prices turned around in the summer of 2009, our government bought an additional 132,276 pounds of U.S. milk powder from Oct. 1, 2009 through Jan. 2010. Something is wrong with this picture.

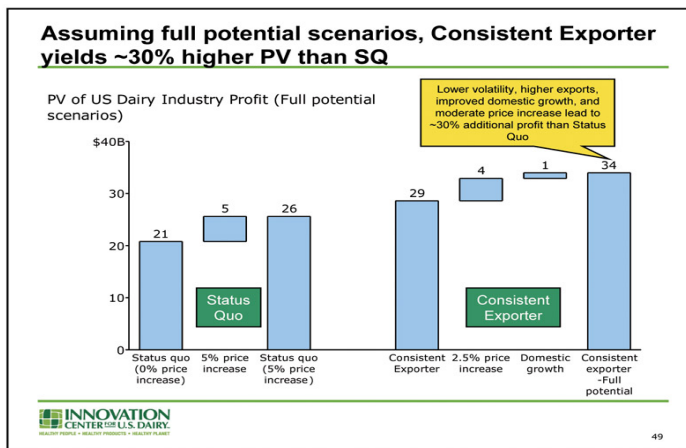
Global supply and demand are now a reality for U.S. dairy producers, whether or not we compete for market share overseas and at home; so aren't we better off competing?

Since at least August of 2009, U.S. product prices and the milk prices paid to dairy farmers, have lagged behind other nations, like New Zealand (Graphs attached). Part of the reason for this is the government purchases under the DPPSP. But another key reason is that we do not make – and market – products that foreign buyers (and in many cases domestic buyers) want. The DPPSP, along with the government-set “make allowances”, play a large role in holding back U.S. innovation and marketing. Instead, our cooperatives – through the CWT program – collect producer assessments to pay for buyer discounts on the products they make to sell them overseas.

In 2010, we saw record exports of dairy products moving at the market. Instead of using producer assessments to pay for buyer-discounts, the U.S. should be focusing on making the products our foreign customers want and developing these growing markets to enhance producer returns. This, again, comes back to federal dairy policies and programs and what these policies and programs “promote” in terms of business models in the dairy processing community (both cooperative and proprietary plants).

Making improved products as a consistent supplier on the world market also helps deter imports by making the U.S. more globally competitive instead of serving as the “balancer” of world supplies.

Through the 10-cent per hundredweight dairy promotion and research assessment authorized in 1983, U.S. dairy farmers paid for Dairy Management Inc.’s Innovation Center for U.S. Dairy to commission the Bain Report entitled “The Impact of Globalization on the U.S. Dairy Industry: Threats, Opportunities, and Implications.” (http://www.dpac.net/publication_files/impact-of-globalization-on-us-dairybain2009.pdf) This report analyzed global markets and found a “window of opportunity” for the U.S. to become a “consistent exporter” and provide for the unmet global dairy demand.



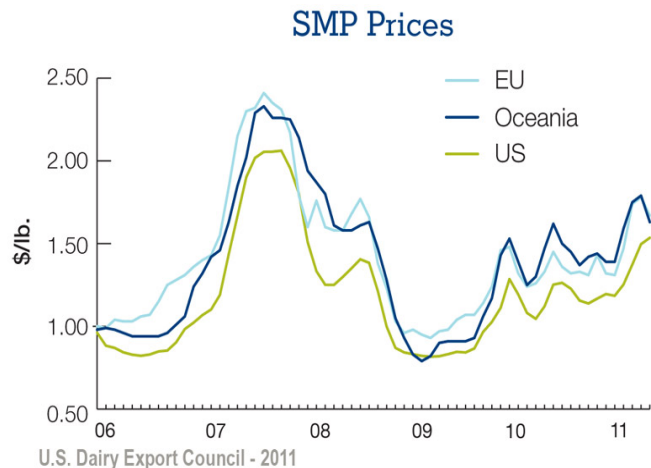
Future dairy policies in the next Farm Bill need to consider this “window of opportunity” and what it means for the ability of U.S. dairy opportunities for growth and profitability in the future.

III. Simplify the Federal Order Milk Pricing System

The next Farm Bill also presents an opportunity to simplify the current milk pricing system by examining the impact of having a two-class system (fluid and manufacturing) instead of the current four classes of milk. In the last Farm Bill, Congress included Section 1509 to set up a Federal Order Review Commission to make recommendations. That, too, was never funded and so the Secretary of Agriculture formed the Dairy Industry Advisory Committee to look more broadly at the dairy industry. One of their recommendations is to evaluate the impact of the current four-class system with product price formulas and “make allowances” compared with a two-class system and competitive pay pricing.

DPAC agrees. In fact, we would like to go a step further and ask Congress to direct the Secretary to receive proposals and hold national hearings on a new and simplified milk pricing system that would establish two milk classes: Fluid and Manufacturing and would price the manufacturing milk based on minimum prices for components (fat, protein and lactose or other solids) instead of minimum prices for classes (II, III, IV). The purpose is to have milk and its components move more quickly between uses to the highest value and to promote consumer-driven product innovation and market development at home and abroad.

Without a long term change in the current milk pricing system, the U.S. dairy industry can, at best, grow 1% per year and, at worst, lose 20% of its current market share as imported dairy proteins will chip away at our industry, while we lose the export opportunities at the same time. We have only to look at the disparity between higher value world market prices for dairy products compared to U.S. domestic market prices to see federal dairy policies are not serving the U.S. dairy industry, or its farmers, in the increasingly global marketplace.



For example: World markets trade skim milk powder (SMP). The U.S. makes very little SMP compared with major manufacturing of nonfat dry milk (NFDM). The difference is SMP has a standardized protein content (34%). NFDM is not as consistent in protein content, having a standard between 34 and 37%. Often, NFDM contains more protein than SMP and must be blended with lactose to achieve the 34% protein content. Yet NFDM is typically priced lower than SMP, which makes the per-point of protein value returned in the dairy farmers’ milk price even lower.

US-produced NFDM also does not always meet the international customer’s specification for quality, which is often higher than the USDA-CCC specification for government purchases under the current Dairy Product Price Support Program (DPPSP). NFDM production is supported by the DPPSP, whereas SMP production is not.

For decades, the U.S. dairy industry has been geared, and plants have been built, around the model of making and storing government-spec NFDm as a milk-balancing service, and a “make allowance” is deducted from the NFDm price before that value is used in the milk pricing formulas.

IV. A Voluntary Market Adjustment Tool: Not Mandatory Supply Management

DPAC has repeatedly expressed its concern about any type of supply management that penalizes dairy producers, pits region against region, is nationalized and centralized, takes a “one-size-fits-all” approach, and imposes government-mandated production penalties or controls.

As dairy farmers, we do not believe that a nationalized, centralized, one-size-fits-all supply management or “market stabilization” program, such as the one being promoted by National Milk Producers Federation, is the answer for us or the industry.

A mandatory supply management or market stabilization program would:

- Transfer more decision-making control from the farmer to the “system;”
- Facilitate more concentration of market power in our industry;
- Make the U.S. less competitive globally;
- Create the potential for even more dysfunctional markets.

All of these concerns are harmful to dairy farm families, rural economies, and transition of dairy farms to the next generation in rural America.

DPAC is promoting a voluntary compromise: The Market Cow Bonus Program (MCBP). If Congress determines a “market adjustment tool” is necessary for the dairy industry, it should be a tool that leaves the decision-making to the independent dairy farm businesses, not the government.

The Market Cow Bonus Program (MCBP) proposal would be:

- 100% producer-funded.
- Fair, because all producers would pay in, and all producers would have the opportunity to receive bonuses from that fund for culling more aggressively from their own herds during times when a declining milk price (not margin) triggers it.
- Voluntary, because producers would make those culling decisions on the farm to qualify for bonuses, instead of the government deciding how much to penalize producers at certain “margin” triggers under mandatory stabilization proposals like NMPF’s Foundation for the Future.

In an economic analysis completed recently, the Market Cow Bonus Program, as a voluntary market adjustment tool, was “simulated” to reduce government expenditures on MILC by up to 11% from 2013 through 2018 while improving Net Farm Operating Income for all farm sizes. (See attached “Analysis of the Impacts of a Market Cow Bonus Program in the United States” by Charles F. Nicholson, Dept. of Agribusiness, Cal Poly San Luis Obispo – May 2011.)

V. Safety Nets & Managing Risk

As the Milk Income Loss Contract (MILC) program is being evaluated for modification or replacement, some producers from various regions still appreciate this direct payment approach as a dairy farm safety net; others are ready to move to an individual risk management approach.

In general, however, dairy farmers prefer to earn value for their product in the marketplace instead of receiving government payments.

I favor solutions that reduce, not increase, government's involvement in dairy. There are some good ideas out there that are budget-neutral, such as the Dairy Industry Advisory Committee suggestion of Farm Savings Accounts, and ways to transition from MILC to individual risk management tools.

However, when it comes to NMPF's Foundation for the Future and the "national margin insurance" contained in that plan, I have great concerns. And I'm not alone. It may sound good or look good on a calculator, but in reality, it is tied to a margin that triggers penalties on milk production at the same time!

The FFTF "national margin insurance" plan seeks to improve farmer income and reduce milk price volatility; however, it is a band-aid approach with clearly regional impacts. While FFTF seeks to ensure farmers a "minimum margin" of milk price over feed cost. It at the same time enables the government to limit the milk each farmer supplies to the market by mandating penalties (See attached article on the math formulas).

This creates many questions and concerns for dairy farmers:

- What will the margin insurance truly cost taxpayers?
- Will the government scale it down in subsequent years to become worthless?
- What benefits will producers see from the "margin protection" when they are penalized at the very same time for 2% or 3% or 4% of their base milk production, even if they did not expand?
- Doesn't this push even more of the price risk on dairy producers instead of having shared risk throughout the supply-chain with product development that is market-driven?
- Will this make dairy markets even more dysfunctional than they already are today?

There are other options of managing risk that are less "centralized" and more "individualized." For example, the DIAC idea of Farm Savings Accounts. There are also individual risk management tools available, like LGM-Dairy, which has a proven track record, but recently ran out of funding. Producers could be encouraged to use these and other individual risk management tools by transitioning dollars from MILC.

Furthermore, an important consideration for successful risk management by farmers is to have a functioning market so producers can manage their own individual milk "margin" at the farm level.

In the corn market, for example, there are lots of different products made with corn. Those products have their own markets trading, and you can see what they are doing on a daily basis. Yet there is one price for corn based on all those markets. Dairy farmers will be able to better manage their risk when we have better price discovery and more transparent markets.

But most importantly, will Congress be willing to listen to dairy farmers and to accomplish the pricing and marketing reforms that are necessary if we allow a nationalized, centralized, one-size-fits-all “Margin Insurance” and “Market Stabilization” program to be passed as in NMPF’s Foundation for the Future (FFTF)? Probably not, and that is what concerns me – and other dairy farmers – most of all.

Conclusion

Recovering from the money borrowed to stay in business in 2009 will take many dairy farms up to five years. For 2011, milk prices are promising, but rising corn and soybean prices are keeping the margins tight. We still have varying degrees of economic and emotional stress on dairy farms in the U.S., and in the rural ag infrastructure that relies on a strong dairy production sector.

It is a privilege, not a right, to dairy in the U.S. But federal policies often work against us. I look for Congress to be reasonable and to provide policies that encourage the opportunity to be profitable, not a guarantee of profit.

I want to share with you an excerpt from an April 15, 2011 *Farmers Exchange* article written by Dave Forgey, a dairy producer from Logansport, Indiana, and member of the DPAC board of directors:

“One small solution I would like to share involves the Bain Report, which is something that we as dairy producers all invest in through our checkoff dollars with DMI. It shares the potential we have to produce for the world market if we choose to produce the products the world demands. It also shares that we need to become consistent players in that market if we want to be considered reliable.

If we had been doing that over the last two years, there would actually have been a higher price for our milk than we received. I'm sure producers are aware that during 2009 the average price received across the U.S. for Class III milk was \$10.50 and Class IV was \$10.10. Would it then surprise them if I shared that the New Zealand price for manufactured grade milk converted to U.S. standards and U.S. dollar value was \$13.10? How about 2010, when our Class III price averaged \$14.40 and our Class IV price was \$15.09? The New Zealand price converted was \$17.50. Adding our Class I and II differentials made our mailbox price about the same as New Zealand, but you must realize our Class I and II price is based off the Class III and IV price. Our mail box price could have averaged from \$2.50 to \$3 higher the last two years if we had used the New Zealand price as our manufactured grade price. New Zealand produces less milk than California but is still the world leader in marketing.

The best solution is for our policymakers to recognize that our manufacturing price is below the New Zealand price and to call upon our industry leaders to tell dairy producers what they intend to do to improve the marketing and product development instead of how they plan to stabilize prices by implementing supply controls and margin insurance. We must shake loose the complacency that has settled over our industry since our 15-year experiment with marketing as an exercise in class allocation, where value is driven by a thinly traded Chicago Mercantile Exchange.

Mandatory supply management or “market stabilization” will not help the family dairy farm business survive and thrive in Michigan or the U.S. For example, the Informa Study released a few months ago showed Michigan would be among the five states that would have had been hardest-hit by withheld payments for milk if FFTF had been implemented during 2009 using “margins” to trigger the production penalties. The other four states mentioned in that report were Wisconsin, Minnesota, Pennsylvania, and New York.

Supply management is not a solution for dairy producers. It is important to the public that dairy production continue throughout the various milksheds in this country and that future policies discourage further concentration of market power. This is the United States of America. Federal dairy policy in the next Farm Bill should look to:

- Improve market transparency, accuracy and timeliness;
- Simplify the milk price discovery process with fewer classes and more competition;
- Position the U.S. to be a consistent and innovative supplier on the world market by ending government price support purchases, eliminating export discount programs and including policies that encourage innovation and market development; and
- Position U.S. dairy farmers for the opportunity to be profitable by supporting tools and processes that allow producers to make business decisions and manage their risk at the farm level.

I would like to thank the Senate Agriculture Committee for coming to Michigan, and I hope that the information presented here today will be valuable as you tackle federal dairy policy in the next Farm Bill.

Attachments:

- DPAC Cornerstones for Change
- DPAC Open Letter to the Industry and Policymakers
- DPAC Draft Bill Outline
- Analysis of the Impacts of a Market Cow Bonus Program in the United States (Nicholson May 2011)
- Various article from dairy magazines
- Bain Report on Impact of Globalization
- US DEC Export “Dashboard” – April 2011