S. HRG. 106–721

FEDERAL DAIRY POLICY

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

ON

FEDERAL DAIRY POLICY

FEBRUARY 8, 9, 2000

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Wednesday, February 9, 2000

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APPENDIX

FEDERAL DAIRY POLICY

TUESDAY, FEBRUARY 8, 2000

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The Committee met, pursuant to notice, at 9:00 a.m., in room SH–216, Hart Senate Office Building, Hon. Richard G. Lugar, (Chairman of the Committee), presiding.

Present or submitting a statement: Senators Lugar, Fitzgerald, Craig, Santorum, Harkin, Leahy, and Conrad.

OPENING STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN. This hearing of the Senate Agriculture Committee is called to order. We have this morning a number of distinguished witnesses including the distinguished governor of Wisconsin, at least six of our colleagues in the U.S. Senate, 4 members of the House, and the Commissioner of Agriculture, Mr. Rudgers of New York. And we look forward to hearing from all you. I will dispense with an opening statement except to say that the hearing comes about through agreement at the end of the last session of the Congress. Those of you were following our deliberations on that day will recall that pledges were made to Senators who were conducting extended debate on the dairy issue that the Committee would hold hearings on dairy policy in which all views could be heard and which once again we could examine this very, very important industry in America.

And so this is the first of the 2-days of hearings. Tomorrow we will have another full day of opportunities and we have called witnesses from public life. Likewise, the United States Department of Agriculture; we will have Keith Collins reviewing from the standpoint of USDA agricultural policy and dairy policy, and then, including that this morning, a number of witnesses describing the current status and structure of the dairy industry.

It is my privilege to call upon the distinguished witnesses and I will ask the governor of Wisconsin to testify first and then we will proceed through our colleagues in the Senate. I will ask each of you, if you will, to give 5-minutes of testimony. Your remarks in full will be published in the record, but as a courtesy to all of the witnesses, because we know that our public witnesses will take us well into mid-morning, if not longer, and then we still have the USDA and the other witnesses, we will try to proceed with the 5-minute time limit for testimony. Likewise, for comments or questions from Senators if we come to those rounds. Governor Thompson, it is good to have you, as always.

[The prepared statement of Senator Lugar, can be found in the appendix on page 70.]

STATEMENT OF HON. TOMMY THOMPSON, GOVERNOR, STATE OF WISCONSIN

Governor THOMPSON. Well, thank you so very much, Chairman Lugar, and thank you so very much for holding this hearing. It is wonderful and I thank you so very much for taking me out of order. Mr. Chairman, I would like to thank you for holding these hearings. I certainly appreciate your interest in agriculture and your desire for agriculture and for this committee to reclaim the issues associated with dairy, issues that affect Wisconsin probably more so than any other state in America.

Wisconsin is the Nation's top producer of cheese. In fact, if Wisconsin were a Nation, it would be the second leading cheese producer in the world, second to New Zealand. My state has more dairy farms than the states of California, New York, and Pennsylvania combined. However, the number of family farms in my state is dwindling rapidly, and with their loss, we are witnessing the demise of the very people who helped build this great country, our proud farm families.

In 1990, to give you some idea, 34,000-dairy farm families existed in Wisconsin. Today, that number has plummeted to 21,000, representing a loss of three daily, farms each day for an entire decade. What is most distressing is the dramatic increase in the number of farms that have gone out of business since the Northeast Dairy Compact was enacted. Between 1997 and 1998, more than 2,000-family farms have folded, increase of roughly 100-percent over the previous average yearly loss.

Ladies and gentlemen, to say Wisconsin's dairy farms are in trouble is an understatement. They are in dire straits and I am at a loss to understand why Congress continues to stand with a heavy foot on the throat of the Wisconsin dairy farmer. As all of you know, Wisconsin dairy farmers have been discriminated against under the Federal milk marketing order system commonly known as the Eau Claire rule ever since 1937.

Congress has attempted to update this pricing regime for years. Farm bills in 1980, 1985 and 1990 all called for reform but failed. When discussions began to take place in the last farm bill, we thought our dairy farmers might finally get equal treatment. However, when the final version of the 1996 farm bill emerged, there were no market based reforms. Instead the farm bill let the USDA decide what type of changes were necessary to reform the 1937 system and was able to consolidate the 31-milk marketing regions nationwide. It did consolidate it to 11.

It also granted temporary consent to the Northeast Compact while the USDA considered action. In January 1998, Agriculture Secretary Dan Glickman proposed two potential approaches to reforming the milk pricing system. While I personally as governor was not pleased with the scale of the reforms, I was pleased finally that some reforms would be implemented and that the Northeast

Dairy Compact would be eliminated when the new fiscal year began October 1, 1999.

I was confident the reforms the USDA created would be implemented because there was no reason to believe otherwise for the Senate held no debates on the Federal milk marketing order system or dairy compacts in any committee nor on the Senate floor. However, as the Congress was wrapping up the final appropriation conference bill, dairy became the issue. At the last minute, a bill was added to the final package to throw out the reform plan the USDA spent 2-years developing. The spending package also included language to extend the Northeast Dairy Compact until September 30, 2001.

Wisconsin farmers, along with many of their Midwestern peers, were again left on the political auction block. Compacts were supposedly designed to save family dairy farms. Instead the opposite has proven to be true. Together compacts and the Federal milk marketing orders have resulted in a devastating effect on Midwestern dairy farmers, driving milk prices to record lows and family dairy farms closing to new heights.

Mr. Chairman, some individuals argue that a compact in one area of the country has no effect in another part of the country. This is either economic ignorance or intentional misrepresentation. Try as we might, we cannot evade the power of the marketplace. A compact in one region will lead to lower prices in another region because we are lessening, not increasing, consumer demand due to higher prices.

When supply outstrips demand, something has to give. In the case of compacts, the Federal Government is again asking consumers in the compact regions and dairy producers in the non-compact regions of the country to do the giving. Vermont's production increased 4-percent in 1998. Production in the other five compact states was up 2½-percent. In fact, a University of Wisconsin—I got one final page and I will finish up quickly, Mr. Chairman—in fact, a University of Wisconsin study estimates the real cost of dairy impacts exceed $145,000 in lost farm revenues per year in non-compact regions.

Even those states with compacts are witnessing a decline in small family farms, as Vermont is losing farms with herds with less than 100-cows. So while the United States is charging into the longest period of economic growth in history, our dairy farm families are watching it roll by and over them.

Simply stated, we are doing our national dairy industry a real disservice if we continue to price milk based on the location of the cow and proceed down the path of regional pricing compacts. What the Wisconsin and American dairy farmer will benefit most from is bold and dramatic reform that eliminates Eau Claire as the standard for setting milk prices paid to farmers and forgets about pricing milk regionally.

Mr. Chairman, I urge you strongly and this committee to rid the entire country of dairy compacts and do not create more. Thank you so very much for having this opportunity, Mr. Chairman.

[The prepared statement of Governor Thompson, can be found in the appendix on page 71.]

The CHAIRMAN. Thank you very much, Governor Thompson. The Chair will say that as each of our distinguished public witnesses concludes, he or she is free to leave the podium as opposed to participating in the further dialogue, and I will call upon our distinguished colleagues from Congress in the order in which they have appeared. And that will be Senator Specter, Senator Grams, Senator Kohl, Senator Jeffords, Congressman Kind and Senator Feingold. Senator Specter.

STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM PENNSYLVANIA

Senator SPECTER. Thank you very much, Mr. Chairman, and thank you for convening these important hearings. This is an extraordinary group of witnesses in this major Senate hearing room so I will be very brief. My full statement, I know, will be included in the record as you have announced.

The CHAIRMAN. Included in full.

Senator SPECTER. And I appear to strongly support the dairy compact being extended to the Mid-Eastern states, states like Pennsylvania. There has been an extraordinary fluctuation in the price of milk, as high as $17.34 per hundredweight in December of 1998 to exactly 1-year later $9.63 per hundredweight. And with that kind of a fluctuation, it is just impossible for dairy farmers to plan and more fundamentally for dairy farmers to stay in business.

Pennsylvania has many small dairy farmers and in the era from 1993 to 1998, Pennsylvania lost between 3- to 500-dairy farmers a year, more than 11-percent of the farmers in the state. Now, it is a Pennsylvania issue that agriculture is Pennsylvania's number one industry and that dairy is the largest component of Pennsylvania's agriculture. But it is a national matter to maintain an adequate supply of milk so that it gets to the consumers and there is a delicate balance to be maintained between a free market and just the bit of governmental assistance which will maintain the small dairy farmer.

We do not want to see a situation arise where the large corporations control dairy, nor do we want to see a situation arise where certain states which may have a competitive advantage because grain costs dominate the market and, in effect, squeeze out other dairy farmers. The compact which has been in existence in the northeastern part of the state has been very successful—northeastern part of the country—has been very successful and when some of the states, Vermont, New Hampshire, Massachusetts, Connecticut, have the benefit of these compacts, as a matter of fundamental fairness, it ought to be extended to states like Pennsylvania and other states which wish to participate.

There is not a matter of cost to the Federal Government and it is a matter of basic fairness. Now, we had a fierce battle last year known to those even beyond the people assembled in this room, and I sit next to one of my best friends, Senator Herb Kohl, who chaired with me the hearings on Ruby Ridge in this room where we saw eye to eye and we see eye to eye on most matters, and I believe this matter can be accommodated so that Pennsylvania farmers can live as well as Wisconsin farmers. So I urge you, Mr. Chairman—I know your fairness and your astuteness and your experience—I know you will give consideration, but I think the merits support extension of the compacts to states like mine. I yield the balance of my time, Mr. Chairman.

[The prepared statement of Senator Specter can be found in the appendix on page 77.]

The CHAIRMAN. Well, thank you very much, Senator Specter, and I appreciate your compliment. This really requires the wisdom of Solomon and beyond.

Senator SPECTER. I still feel confident about the judgment in this matter, Mr. Chairman.

The CHAIRMAN. I appreciate that. Senator Grams.

STATEMENT OF HON. ROD GRAMS, A U.S. SENATOR FROM MINNESOTA

Senator GRAMS. Thank you very much, Mr. Chairman, and the members of the Committee. I want to thank you for the opportunity to be here today and to address you concerning the critical issue of Federal dairy policy. It is my hope that these hearings will shed some light on the unfair and the outdated pricing structure that we currently live under and help turn the tide in our country to free markets for our dairy farmers.

Mr. Chairman, I want to point out first today that milk, which is an important member of the food group, is also a beverage that competes with a host of other beverage choices for the consumer's dollars. In 1998, each American consumer drank 23.8-gallons of fluid milk products. This is compared to 56.1-gallons of soft drinks, 15-gallons of fruit juices, 13.9-gallons of bottled water. In fact, per capita beverage milk consumption has declined from 28.6-gallons in 1975 to just 23.9-gallons in 1997.

Our Federal pricing policies also run counter to the conventional wisdom that we need to be promoting milk consumption as an important part of a healthy diet. If we continue to artificially raise milk prices, we cannot expect farmers to be successful in the long-run competing against each other and other beverages available in the grocery store. Our daily policy must be focused on permitting farmers to capture additional market share, both domestically and internationally.

That is one of the reasons I have introduced legislation, Senate bill 1930, which would eliminate the Federal milk marketing orders and allow farmers to compete in the free market. Eliminating the milk marketing orders would end the regional price discrimination that hamstrings Upper Midwest dairy producers and would obviously benefit the consumer, especially low income families with children that need milk for good health and spend a high percentage of family income on food.

The milk marketing orders artificially inflate prices for beverage milk and other dairy products within a region which prevents producers from lower cost regions, such as in the Upper Midwest, from penetrating markets in other areas. Not only does it keep Upper Midwest producers from increasing market share in other regions with lower cost, high quality milk, but the Federally mandated higher prices for fluid milk in other regions stimulate production there resulting in more milk flowing into the production of manufactured dairy products which in turn depresses prices that Minnesota producers receive.

So the adverse effects of milk marketing orders on Minnesota farmers are twofold. In fact, the milk marketing order system, while raising the price farmers receive for beverage milk, actually depresses the prices farmers receive for manufactured dairy products, and the Upper Midwest Federal Order used only 13-percent of its milk as beverage milk in January 1999, the remaining 87-percent going to the production of manufactured dairy goods.

Mr. Chairman, without Federal orders, Upper Midwest farmers would receive a higher price on the 87-percent of its milk used for production of processed products. How can Congress possibly justify artificially raising the price that farmers receive for fluid milk and depressing the price they received for processed products? It cannot. Congress absolutely should not be picking winners and losers in such an arbitrary manner.

Minnesota farmers do not want special advantages. They simply want the heel of an antiquated system off their neck. No other consumer food product is micromanaged as much in America as the dairy industry. As our colleague, Phil Gramm, memorably put it last year, "dairy compacts would make a Soviet commissar blush." The same goes for the U.S. milk marketing order system. The communist countries used to price goods and services using complicated formulas representing estimated values of input. Like the Federal milk marketing orders, it had little to do with supply and demand.

Mr. Chairman, my bill would allow the production of milk in the United States to be based on a fair playing field for all producers and would that be good for the Upper Midwest? Yes, it would. Would it be good for the consumer and for American agriculture as well? Yes. The Upper Midwest is blessed with the natural conditions conducive to milk production including a favorable climate, low feed costs and ample water supplies. We are the most competitive producers in the country and the American consumer should be able to reap those benefits.

So, Mr. Chairman, in closing, I just want to thank you again for holding these hearings. I hope it does lead to some changes in this dairy industry or the pricing. Our dairy farmers, as Governor Thompson pointed out, are just at the mercy of antiquated, old-fashioned, outdated milk marketing order system. We would never put a dairy policy like this in place if it were being constructed today. So I just hope we can put some fairness into this dairy policy so when I go home that I can tell my dairy producers, our farmers who get up every morning to go out and milk those cows, that we are not going to discriminate against them.

Mr. Chairman, I also have the remaining part of my statement I would like to have entered into the record as if read.

[The prepared statement of Senator Grams can be found in the appendix on page 80.]

The CHAIRMAN. The record will include your statement in full. We thank you, Senator Grams.

Introducing our next testimony of Senator Kohl, I would simply mention, as I said at the outset, before Senator Kohl arrived, that on the concluding day of our session, our Majority Leader, Senator

Lott, called me to the floor because he said that Senators from Wisconsin and Minnesota in particular wanted assurance from this committee, as did Senator Lott, that we would hold hearings. And one reason for concluding the debate on that day was a pledge on my part on behalf of our committee to hold the hearings. So I am very pleased that Senators from Wisconsin and Minnesota are here. Senator Kohl was a leader of that debate and it is good to call upon you and have you here in our hearing this morning, Herb. If you would commence with your testimony.

STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM WISCONSIN

Senator KOHL. We thank you, Mr. Chairman, and we thank you for holding these hearings today as you promised you would. We also thank witnesses who have come a long way to help us sort out our antiquated and unfair dairy pricing system. Mr. Chairman, there are those who think that these hearings are meaningless. They argue that Wisconsin dairy farmers need justice and we are only giving them words. They point to the long history of backroom deals and last minute betrayals that have tilted our current dairy laws hopelessly against the family farmers of the Upper Midwest.

Mr. Chairman, I am not ready to give up on my colleagues in Congress. I continue to hope that they will side with us when they come to understand how far our dairy pricing system has strayed from the basic American principle of honest pay for honest work. Last November, as you point out, when we forced Senate leadership to look at our argument literally by barring the door, we got strong and open commitments from the majority and minority leaders to fight the regional dairy pricing fixing cartels known as dairy compacts.

This year with hearings like this and with legislation I hope this committee will report and through the efforts of those of us from the Midwest committed to this fight, I believe that we can change more minds. The current pricing system is like a vampire. It cannot survive in the light of day. So I am not ready to give up on Congress and I am certainly not ready to give up on the struggling family dairy farmers of my state.

Right here with me today I have a list of the 10,519-dairy farmers who stopped milking over the last 3-years. If these were farmers ruined by a natural disaster, then it would be a list of those eligible for FEMA loans and grants to rebuild their businesses. If these were farmers put out of business by unfair trade practices in other countries, then it would be a list of those eligible for trade adjustment assistance. But because their ruin was brought on by an unfair policy intentionally imposed by their own Federal Government, this is only a list, a sad, sad record of a way of life that should not have to die.

Mr. Chairman, we in the Upper Midwest are not asking for a bailout. We are only asking that Congress end a dairy pricing system that is uncompetitive and un-American. The facts are clear, number one, increased prices in some regions either through compacts or Federal orders result in overproduction that lowers prices for farmers outside the protected region. History shows this to be demonstrably true.

Number two, dairy compacts are an unprecedented price fixing scheme contrary to the principles of free markets that have made America's economy the strongest in the world.And three, the way to end regionalism and divisiveness is not to expand compacts and exacerbate milk price distortions but to develop and enact policies that help all farmers equally. Those who suggest we can have a national dairy policy to help all farmers and regional policies like compacts are just plain wrong.

Mr. Chairman, it is ironic that the Midwest is often accused of regionalism for opposing policies which help only other regions. The Upper Midwest has never sought special treatment. We have only sought a level playing field. We need a national dairy policy that will help all family dairy farms throughout our country, that will neither distort markets nor tax consumers. And we need you, Mr. Chairman, and the members of your committee, to commit to pursuing that goal and pursuing it openly. Congress should never again agree to a last minute special interest dairy deal that goes against every basic principle of fairness and American free enterprise. I thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Kohl. Senator Jeffords.

STATEMENT OF HON. JAMES JEFFORDS, A U.S. SENATOR FROM VERMONT

Senator JEFFORDS. Thank you, Mr. Chairman. It is a pleasure to be here with you. As you know, I have been deeply involved in dairy policy since I got here some 20-odd years ago and so I have been through a number of trials and tribulations and programs and all, and it is just seems to us here in Vermont that the one that we have now certainly is the best one we have had as far as allowing compacts to be able to satisfy the needs of a region.

We have to remember what the basic policy of the dairy policy is and that is each region of this country is entitled to have an adequate supply at a reasonable cost of fresh milk. To say that it can all be supplied from the West or the Midwest is not consistent with the policy nor is it consistent for the Nation as we have varying times when various production levels are available. Again, the basic policy is to assure consumers of adequate and dependable supplies of pure wholesome milk products from the least costly source.

I recognize that my Senate colleagues from the Midwest have, and very understandably, raised the dairy issue to a new level of concern and I welcome the opportunity to respond to their call for productive changes in our dairy policy. There is nothing I would like more to do than to join my friends from the Midwest in common cause to improve our dairy situation. I say I have worked over the years with the Midwest and time and time again we have found common ground. It is time to work together again.

But let me be frank with each other. The key issue that has divided us in our time here and which continues to divide us is the insistence that one part of the country should be seen as the source of our nation's supply of milk beverage. This insistence has been and still remains simply contrary to the overwhelming will of Congress and contrary to the law. The real issue, the very nature of our basic supply and demand, so extends way beyond the mere interest of a single constituent group, regionally and on behalf of the Nation as a whole, the Congress simply will not yield to the destruction of our local supplies of fresh wholesome drinking milk which is the basic law.

So I call upon my colleagues in the Senate, especially my friends from the Midwest, to look elsewhere than to reformation of the fluid marketplace for the solution of our problems that dairy faces. I make this call in the spirit of cooperation and with a positive spirit. One looks at the increase in milk production and cow numbers in the western states, such as California, Arizona, New Mexico, Idaho, Washington, and one could determine that the fight is not regional supplies of milk, but it is the production of cheese and other manufactured products which when overproduced caused depressed farm milk prices across the country and difficulties.

Let me go through what has happened in that regard and I ask my members from the Midwest to take note. USDA's Commodity Credit Corporation purchases of surplus dairy product percentage by regions show that in fiscal year 1996–97 the Midwest accounted for 56.8-percent of surplus dairy products purchased, 43.2-percent from the West, 0-percent from the East.

In 1997–98, the Midwest percentage was 9.6-percent and the West was 90-percent, and the East was .2-percent. As of April 1999, the West contributed 97.2-percent of the Commodity Credit Corporation [CCC] purchases. It is clear that the overproduction is not in the East; the solution may be in the East, but it is the West that is the problem. I also have here to show you what has happened for consumers in our area. The price to consumers has gone down. It is just purely coincidental that we picked Kohl's Market out in Wisconsin to compare with, but I would point that in Vermont at this particular time the price per gallon was $1.39 and out in Wisconsin it was $1.79. So we have a compact which has cut the cost to the Government, which has cut the cost to consumers, which has aided our farmers, and it is something that ought to be looked at as a solution because it is not the problem. Thank you.

The CHAIRMAN. Thank you very much, Senator Jeffords. I call now upon Congressman Kind of Wisconsin. We are glad to have you at our hearing this morning.

STATEMENT OF HON. RON KIND, A U.S. REPRESENTATIVE FROM WISCONSIN

Mr. KIND. Thank you, Mr. Chairman. I am delighted to be here and thank you for the opportunity of having not just myself but a couple of my colleagues from the House side testifying in regards to this very important matter, and let me just begin by coming to the defense of my esteemed Senator from Wisconsin that some of the best consumer purchases that can be made in the country can be found in Kohl's department stores so I hope you are not under any illusions with that last graph that was just put in front of you.

But, Senator Lugar, I represent a district in western Wisconsin that is one of the largest dairy producing districts in the Nation. It also happens to be home of a very fine city called Eau Claire. And I am sure the Chairman is aware of the significance of that geographic location. I have over the last 3-years representing that district found it incredibly difficult trying to explain to the family farmers back home why we have a milk pricing system that discriminates upon them merely because of geography and location. And the bottom line is that there is no real economic justification for it anymore. What may have made sense back in the 1930s to ensure an adequate supply of fluid milk in certain regions of the country that had deficient milk supplies no longer holds true today, not with the interstate highway system, the ability for us to transport milk to all regions of the country with relative ease overnight. There is no economic justification anymore today.

The dairy industry is the largest industry in the state of Wisconsin. It is a very proud industry. We have approximately 22,000-dairy farmers that produce close to 23-billion pounds of milk yearly. Gross milk receipts for 1998 were approximately $3.5 billion. Roughly 160,000-people are employed in our state's dairy industry. 85-percent of Wisconsin's milk is processed into cheese and other manufactured products and Wisconsin cheese is recognized nationally and internationally.

What does not exist in the state of Wisconsin, and this is true for the Upper Midwest, are our family farmers who are looking for any particular advantage. All they are asking for is the ability to compete fairly in our own domestic market with a level playing field and to end the regional competition that now exists in this country. What also does not exist in Wisconsin, and it is true in the Upper Midwest, are large corporate dairy farms. In fact, there have been some fallacies perpetuated out here with some members of Congress in the national media who think that the representatives from the Upper Midwest are here going to bat for large corporate interests back home. Just the opposite is true. The average dairy herd size in Wisconsin is 59-head, compared to Vermont which is 85-head; New York has 81-cows. In Wisconsin, just 2-percent of our farms have over 200 cows. In Vermont, it is 7-percent of their farms over 200-cows. In New York, 6-percent over 200-cows. So it is not as if we have a lot of large corporate dairy interests that are demanding change. What we have are a lot of small family farmers who are just asking for an opportunity to make a decent living, compete domestically, so they can provide for their families. It is a very proud history.

One other point I would like to make to the Chairman here today, there are, I believe, international trade implications with our dairy policy in this country and we saw the results of the World Trade Organization [WTO] talks in Seattle. One of the greatest obstacles we have in a new round of international trade talks is in the agricultural sphere. Agriculture is our number one export market industry in this country and yet if our trade representatives are to have any credibility going into a new round of trade talks, we need to get it right at home first.

In fact, I along with Senator Pat Roberts, a distinguished member of this committee, and a handful of other representatives had a chance about a year ago to go to Brussels to meet with members of the European Commission and members of the European Parliament in regards to the changes or proposed reforms of their common agricultural policy. We all know that the European Union [EU] has a heavily subsidized export dairy program in place right now and as we discussed with them in gentle terms the desire for change, their response was quite illuminating. Basically they responded do not come over here—and I am paraphrasing, of course—and lecture us on our dairy policies and our state subsidies to the dairy industry when you cannot even get it right at home.

And I think we are going to run into this difficulty in future trade talks with other nations as long as we are quick to point the finger of blame on other countries who refuse to negotiate in good faith and practice good fair trade policies in accordance with WTO policies, so long as we pit region against region, continue this 1930 antiquated milk pricing system in our country, and I just leave that with you today, Mr. Chairman. I have a more fully and detailed written statement that I will submit for the record, but thank you again for the opportunity to testify. Thank you.

[The prepared statement of Representative Kind can be found in the appendix on page 85.]

The CHAIRMAN. Well, thank you for coming. Your statement will be published in full. I take the point that you have made, Mr. Kind, that WTO apparently yesterday made a late announcement that they are going to attempt to revive agriculture, and not the large agenda that was in Seattle that crashed and burned. But now the embers are being blown on again. Perhaps some negotiations starting in March with no promise of when they will conclude, but certainly your point is well taken and I appreciate your interest in this.

Let me just now call upon your colleague from Wisconsin, Senator Feingold. Russ, it is good to have you as always. Would you please testify?

STATEMENT OF HON. RUSSELL FEINGOLD, A U.S. SENATOR FROM WISCONSIN

Senator FEINGOLD. Thank you very much, Mr. Chairman. And I want to thank the entire committee for holding these hearings and I especially want to thank my colleagues from both the Senate and my friends from the House and Governor Thompson for all joining together to testify today. And I would ask that my whole statement be placed in the record.

The CHAIRMAN. It will be published in full.

Senator FEINGOLD. Mr. Chairman, I am here to simply underscore the simple point that the current Federal dairy policy is not helping anyone. In fact, to put it very simply, Mr. Chairman, it is destroying farmers. It is hurting consumers and it is hurting taxpayers. Over the past 70-years, we have witnessed a tragic transformation of America's dairy industry. Year after year, consolidation and consolidation and concentration have run rampant through our dairy industry and I certainly agree that in nearly every region, whether it be the Northeast, Midwest or west coast, we have seen the disappearance of small and moderate size family farms. But nowhere in the United States has this trend been more glaring than in America's dairyland, my home state of Wisconsin.

Let us just again look at the effect of the Federal dairy policy on Wisconsin dairy farmers. Mr. Chairman, in 1950, Wisconsin had over 143,000-dairy farms. After 50-years, Wisconsin is left with only 20,000-dairy farms. During the 1990s alone, Wisconsin lost more than 39-percent of its dairy farms. In other words, the number of farms we started the decade with, by the end of the decade we had 39-percent less. That is three dairy farms a day being lost for a total of over 13,300-dairy farms. So Wisconsin has lost over 39-percent of its dairy farms in the past 10-years.

Now my colleagues can imagine the impact that this has on communities across Wisconsin. When dairy farms that have been in a family for generations are forced out of business, rural communities are truly devastated. Unfortunately, it seems that the main result of America's dairy policy is its depressing effect on prices. If these policies continue, our farmers will soon be paid 1930s prices for their milk.

Instead of collectively addressing the challenges facing our dairy farmers, Congress has played political games with America's dairy policy. The most significant changes over the past few years, the Northeastern Dairy Compact and the implementation of Option 1–A, failed to ever pass the Senate as a discrete issue on which the Senate voted yes or no. In fact, the only Senate vote explicitly on the Northeast Dairy Compact, and which I was very much involved, resulted in a clear rejection of the dairy compact.

So I have to take this opportunity to take exception to the continuing assertion that compacts are an answer to the problems facing America's dairy farmers. Despite its original intent, I think dairy compacts have hurt small independent producers. Since the Northeast first implemented its compact in 1997, small size family dairy farms in the Northeast have gone out of business 41-percent faster than they had in the two previous years. In fact, compacts often act simply as a device to transfer wealth to large farms. Compacts afford large farms a per farm subsidy that is 20-times greater than the meager subsidy afforded to small farmers.

However, compacts only exacerbate the regional inequalities inherent in our current system. So my message is simple. Just as the compacts ought to end, I think these regional arguments have to stop. We need to restore equality, stop regional bickering, and work to ensure that our nation's dairy farmers can get a fair price for their milk. The simple fact is that our Federal dairy pricing policy is failing to protect our nation's farmers. In fact, one of the greatest forces driving Wisconsin dairy farmers out of business and off the land, Mr. Chairman, is the current structure of the Federal dairy program. And I am not going to go through the whole history of that again as my colleagues have done.

Let me just say that Congress has to recognize that America's dairy market is truly national and that we are in need of a national solution or, to put it more personally, I look forward to the day when I can think of the name of Eau Claire being associated with the fact I hope my daughter is studying hard at the University of Wisconsin Eau Claire today rather than a pricing system that is putting a knife in the heart of Wisconsin dairy farmers.

Finally, Mr. Chairman, I do want to mention one other trend that has gone unchecked and substantially unaddressed and that is the increased concentration in America's dairy industry which is causing farmers to receive a declining share of the retail dollar. In 1981, dairy farmers were receiving a national average of $13.76 per hundredweight, while fluid milk at the grocery store was selling for about $1.85 per gallon, while in August of 1997, dairy farmers were receiving a national average of $12.70 per hundredweight and retail fluid prices were at $2.76 per gallon.

While we have heard a great deal about the merger mania in the grain and livestock industry, market concentration in the dairy industry has gone unnoticed for far too long. We need to address the potential problems raised by the vertical integration of cooperatives, mergers of cooperatives and retailers, and possible price manipulation by retail stores. Mr. Chairman, since you were kind enough to allow me last week to present some of the specifics of this merger mania, I will not go over it again, but I believe this is part of the problem for us in the Upper Midwest and I would say to Senator Jeffords for farmers across the country.

So instead of dealing with an important issue like that of market concentration, Congress has instead been playing political games with America's dairy policy. So again the message is simple. The backdoor deals, Mr. Chairman, have to stop. American dairy farmers deserve a fair and truly national dairy policy and one that puts them on a level playing field from coast to coast, and again thank you very much for following through on your commitment to hold these hearings. I do appreciate it.

The CHAIRMAN. Thank you very much, Senator Feingold, and thank you also for your testimony on the agricultural concentration issue. These are both very serious issues and that is why the Committee in its first 2-weeks has tried to tackle both and we appreciate your testimony on this occasion likewise. Senator Wellstone.

STATEMENT OF HON. PAUL WELLSTONE, A U.S. SENATOR FROM MINNESOTA

Senator WELLSTONE. Thank you, Mr. Chairman. I have a complete statement that I would like to submit for the record.

The CHAIRMAN. It will be published in full in the record.

Senator WELLSTONE. And I want to just mention that Mark Furth from the Associated Mike Producers of Minnesota, I think, will be also testifying later. Let me thank you, Mr. Chairman, and Senator Conrad, for holding the hearings. Let me thank all my colleagues and I think rather than going with any prepared statement—you will just have that on the record—let me just highlight a couple of things that have been said.

First of all, I mean probably the informal way for me to say it is that the extension of the Northeast Dairy Compact, I think, as much as what it means substantively to us, and we have a different interpretation than my colleague from Vermont, is the way in which it was done. I do not think any of us think it was appropriate that it was put on to the omnibus bill. I think there is a lot of anger about it. I think that is what Senator Feingold meant when he talked about a kind of backdoor process.

Second of all, let me also mention this milk marketing order system which is just irrational and very discriminatory toward the Midwest, and we thought Secretary Glickman was taking a step in the right direction, and again what sort of adds salt to the wound is that his, I think, proposal, which was constructive and helpful, was basically blocked.

Third of all, I want to mention this whole issue of forward contracting and where I think—you know, I just have had the most poignant meetings and conversations with hog producers, and they just basically have pretty much lost their right to be entrepreneurs. And, you know, what happens you get low prices, which, of course, with this unbelievable fluctuation in dairy prices is happening to our producers, and then they forward contract with these processes and it becomes vertically integrated, and before you all know it, it just becomes a very corporatized agriculture with conglomerates kind of muscling their way to the dinner table and the kind of family farm structure of agriculture that we all cherish is gone. And I want to signal to you that I think that is an incredibly important issue.

And then finally, I just want to say that ultimately I would like to be up here working together with Senator Jeffords because I think the other issue that we are faced with is that we were at 16.26 and then we went down to 9.63-per hundredweight. I mean producers just cannot survive this kind of wild fluctuation. We need some kind of a stability. We need some kind of decent price. We need some kind of price targeted toward our midsize producers and ultimately I will just tell you if we do not do that, then we are just going to lose our producers.

Finally, I want to emphasize what my colleagues from Wisconsin said, which is, you know, our typical dairy farm is 60-cows. We are the fifth largest producer in the Nation. It is a $1.2 billion business for those farmers and that dollar multiplies over and over again, and if I was to add to what is happening to dairy farmers with what is happening to some of our crop farmers with what has happened to some of our livestock producers with what is happening to our small banks and our small schools and our hospitals and our rural communities, I would say that you have an absolute economic convulsion taking place in rural America.

And I just hope we do not sort of go about our business as usual because I think we need to respond to it. I know that there is a wonderful effort being planned, led I think by the religious community and farm organizations and AFL–CIO and environmental organizations, to come to Washington with a focus on rural America, around March 20, March 21, and I think lots of people will be here with really good meetings with Senators and representatives, and I think that will be good because we just cannot put into parentheses or put aside what is happening in our rural communities.

I really appreciate your holding these hearings, Mr. Chairman, and while I do not always agree with you on some of your positions, I always respect your integrity and I never doubt your word. I thank you.

[The prepared statement of Senator Wellstone can be found in the appendix on page 87.]

The CHAIRMAN. Well, thank you very much, Senator Wellstone. I appreciate your leadership in rural America and wish that you were a member of our committee so you could be a part of this dialogue day by day, but thank you for coming again this morning.

I would like to call now on Congressman Green.

STATEMENT OF HON. MARK GREEN, A U.S. REPRESENTATIVE FROM WISCONSIN

Mr. GREEN. Thank you. Thanks, Mr. Chairman. Thanks for the privilege of being able to appear and offer some thoughts. The disadvantage of going so late in the process is perhaps you are already confused by all these contradictory details and bizarre details of milk marketing orders. The advantage, however, from my standpoint is I will only summarize my testimony and not have to repeat much of what has been said.

Mr. Chairman, I would ask that my written testimony be submitted in full to the record.

The CHAIRMAN. It will be published in full.

Mr. GREEN. Thank you, Mr. Chairman. Mr. Chairman, as you have heard, farmers all across America are hurting. You have heard that not only here but obviously back home and dairy is no exception. When members of this house and the House of Representatives voted to overturn the very modest reforms proposed by Secretary Glickman, many did so with the best of intentions, responding to the pain, the suffering that they are hearing in their home states and their dairy sector. But perhaps what they did not fully appreciate is the depth of the crisis and suffering in the Upper Midwest. You have already heard it from Senator Feingold, but in Wisconsin by this time tomorrow we will have lost at least three dairy farms, three per day.

Over the last 10-years, we have lost more dairy farms than every other state save Minnesota ever had. That is the depth of the crisis that we are facing. The farmers, the observers back in my home state, have a number of frustrations. I will summarize five frustrations that they see.

The first frustration is that many of those who voted to overturn the proposed reforms who voted to restore the current system, have argued that they need this system because of fluctuating prices and instability. Let us not forget those fluctuating prices and instability are under the current system, not under the reforms that the USDA has proposed.

Second, the reforms that the USDA, that Secretary Glickman proposed, were so very modest, they would not have had a huge effect. In fact, they probably would have benefitted just about every district in this Nation, congressional district, just about every state. My consumers are frustrated because if we cannot get these very modest reforms, what hope is there for the more fundamental reforms that we need? When I testified before the counterpart to this committee in the House, Governor Ventura of Minnesota said that in his state people become so frustrated that they have concluded it would be easier to physically relocate the city of Eau Claire to the west coast than to actually get relief within Congress.

My third frustration, frustration we are hearing back home, is that overturning the very modest reforms that have been proposed ignores history. It as if the supporters of the current system are part of the flat earth society. They are locked in a time warp. We all understand why this system was created in the first place back in the 1930s. Since then, technology has changed things. We have refrigeration. We have an interstate highway system. My dairy farmers can get their milk product to your consumers almost as fast as the dairy farmers in your home state.

Now I will not go over it in detail, but Mr. Chairman, you have before you a chart. Actually it is a cartoon from the Pioneer Press that poses the question which of these is Federal policy? All computers are price adjusted according to their distance from Seattle? All oranges are price adjusted according to their distance from Florida? All country music price adjusted according to its distance from Nashville? Or all milk is price adjusted according to its distance from Eau Claire? We know the answer unfortunately.

Fourth frustration. The system that we have now is out of line with current economic and trade policy. And you have heard that. We have in our compact system mini-cartels. We have trade barriers between our own states. At the very time that we are going to every Nation around the world and saying lower your trade barriers or else, we have trade barriers between the states. At the very time when we have missionaries of capitalism from this country going from the tip of Africa to Southeast Asia, telling those nations that their economy does not make sense, that they have to introduce capitalistic forces, in our dairy sector, we are going the other way. That is crazy.

And the final frustration that I would point to in direct contradiction to my colleague and friend Senator Jeffords is the reforms that we are looking for are reforms supported by looking not just at our home state but around the Nation. The coalition which has come together on our side of the issue ranges from the teamsters to Americans for Tax Reform to the Congressional Black Caucus to the National Restaurant Association. The system that we have in place costs taxpayers $149 million per year in tax dollars. It is a tax on milk that artificially drives up the cost of milk to consumers. That chart that the Senator pointed to, those prices are under the current system, the system that we want to change and reform.

And finally, this system weakens WIC and other poverty relief programs by driving up the cost of milk to consumers and weakening the benefits that they receive from the Federal Government. So this is not only current law, bad for our dairy farmers, but more significantly it is bad for taxpayers. It is bad for consumers. It is bad for those who we are trying to help through our poverty relief programs. It is time to end the flat earth society. It is time to recognize modern technology. It is time to restore some basic ideas of capitalism and free trade into our system. Thank you, Mr. Chairman.

[The prepared statement of Representative Green can be found in the appendix on page 92.]

The CHAIRMAN. Thank you very much, Congressman Green, for coming and for offering your testimony this morning. Congressman Ryan.

STATEMENT OF HON. PAUL RYAN, A U.S. REPRESENTATIVE FROM WISCONSIN

Mr. RYAN. Thank you very much, Chairman Lugar. I appreciate it. Thank you, Senators Harkin and Conrad. It is a pleasure to be here. I ask that my full written text of my comments be inserted into the record.

The CHAIRMAN. It will be published in full.

Mr. RYAN. Thank you. And I too know that at the end of the hearing, you do not want to read your long full statement so I would like to just paraphrase. And I know that my colleagues talked about the issue. I would like to talk about the politics of the issue. What happened this last year shows me as a new member of Congress that it is very difficult to get dairy, modest dairy reform from Congress. We have entrenched regional political differences, not based on fact, not based on the merits of the case, not based on core principles that we as elected officials aspire to achieve, but based on regional politics. Basically it is the rest of the country versus the Upper Midwest. That is really what it boils down to.

I will not rehash all the arguments. We in Wisconsin between 1990 and 1998 lost 11,000-dairy farmers. As Mark said, we are losing three a day. This time tomorrow another three dairy farmers we will lose. In my district, which is the southern part of the state, we have lost 3,000-dairy farmers this decade. Why are we losing it? Because we are held at a competitive disadvantage. Rather than going into the facts and the reasons why we are held at a competitive disadvantage, why we are operating under this sort of horse and buggy economic system, let us look at the politics of this.

1996, in the 1996 farm bill that you, Chairman Lugar, did so well to help achieve was a very momentous time for agriculture. In 1996, that farm bill attempted to decouple and give farmers the freedom to farm. That was the case with a lot of our commodities. However, in dairy, because of the difficulties of this issue and because of the regional politics tilted against the Upper Midwest in this issue, we had a problem. So what we solved and tried to do—I was not in Congress at that time—was to get the USDA to come forward with reforms after the 1996 act. The USDA did do that. They came with very, very modest reforms in an attempt to try and equalize and liberalize the dairy markets, try and give more equity to all dairy farmers. So that their success will be determined upon their ability not so much as their proximity to Eau Claire, Wisconsin.

Well, that was what we face this year. Yet, those very modest reforms, which arguably put other regions of the country in a better position or a very similar position such as the Northeast and other parts of this country, were rejected out of hand. What I am convinced is necessary is a strong administration that will push this issue all the way to the end, a USDA that did its work that we saw last year, but an administration working hand in hand with principled members of Congress with midwestern members of Congress to see this through so that at the end of a budget cycle when you are going down the road and you have a big appropriations battle, winding up in October we do not see the capitulation that we saw.

What we saw this last year was a capitulation on the part of the administration and leaders in Congress to bend to the prevailing political forces meaning the plurality of the vote from the Northeast and the South. We need to stand against that. We need a strong administration proposal, an administration that is willing to back its proposal to the end, and leadership in Congress that will see this through to make sure that farmers can prevail based on the merits, farmers can prevail based on the markets, not based on how far away from an arbitrary location in this country they live. Thank you.

I want to summarize it with basically that, but I just want to tell you, Mr. Chairman, you have provided leadership on this issue. Everybody here on this committee understands the issue. We do not have to rehash it, and I think if you talk to our colleagues from the Northeast, some of them in confidence have told me you are right, we agree, but the politics are too strong. I believe that if those members of Congress went home and actually discussed what was included, what were the details of the USDA's proposal, I think that we could have made some momentum.

Lastly, one of my colleagues who was voting against us on the floor—we had several amendments during this—told me that they lost 20-dairy farmers in the last 5-years in their district. We lost 20-dairy farmers in the last week in my district. So I think that the proportionality of this problem has yet to be realized. I think that we have members of Congress who are sticking with their region, not necessarily with their district or with their consumers, who purchased milk pricing. This committee can help educate the rest of Congress. It is an issue that most members of Congress do not know about. It is an issue that most members of Congress, unless they represent dairy districts, have no conception of what is actually happening.

This committee by having this hearing can elevate these issues. I encourage you to continue to do so. I thank you for this and what we need is to work together to push the administration to stand firm behind their proposal and work with our leaders in Congress to see that we do not undercut them. Thank you very much, Mr. Chairman.

[The prepared statement of Representative Ryan can be found in the appendix on page 96.]

The CHAIRMAN. Thank you very much, Congressman Ryan. Let me just comment because you have offered a historical note about the 1996 farm bill. Obviously, great leadership was given by many members of our committee and the House Agriculture Committee, but the compromise that was reached in the conference, and which I think most of us at this table were present throughout that night, early morning, and so forth because dairy was decided last, was essentially, as you have stated, that USDA would offer proposals to try to take the 38-marketing orders or however many there were at that time down to a much smaller number to rationalize the system more along market principles and that the New England Dairy Compact would terminate what amounts to a year ago of October, I guess, the first of October 1998.

Senator Leahy, the distinguished former chairman of the Committee, ranking member at the time, a strong proponent of the dairy compact. Many were likewise backing that position and many thought we ought to rationalize the system. So the compromise was a new marketing order business in America and the dairy compact concluding. Now, both of these situations have been frustrated, and so we are at this point, as you have suggested, through legislative process other than direct action by our committee through its authorizing procedures or through the farm bill at this pass.

So I understand the dispute vividly, having experienced for many years, but nevertheless that is the purpose of the hearing today. Our committee is a part of American democracy. We have many members with strong views. If there is a consensus in our committee to act upon any of a number of legislative proposals, we will attempt to do so, and I presume the House will act correspondingly, and the parliamentary procedures will be as they always are in the Senate, in which we have unlimited debate and considerable leverage, particularly when the session runs long, when appropriations bills are not passed and literally everything is up for grabs including dairy policy.

At that point, our committee is no more effectual than any of you individually, but this is one reason for acting in February to hear this. And we appreciate all the members of Congress taking time this morning in your busy schedules to be with us to offer this testimony.

The CHAIRMAN. I want to conclude this panel by asking for our final governmental witness, at least governmental in the sense of Congress, and something other than the USDA and the industry, the Commissioner of Agriculture of New York, Nathan Rudgers. And we appreciate your coming, Sir.

STATEMENT OF NATHAN L. RUDGERS, COMMISSIONER, NEW YORK STATE DEPARTMENT OF AGRICULTURE AND MARKETS

Mr. RUDGERS. Thank you, Senator Lugar, and I appreciate very greatly the opportunity to address this panel in the final position this morning. My comments this morning are going to be somewhat different than my written testimony. I would ask that you submit that for the record.

The CHAIRMAN. It will be published in full.

Mr. RUDGERS. I appreciate that. You are to be commended as well as the rest of your committee for having these hearings. Governor Pataki and my department have been both very involved in dairy policy and we witnessed first hand some of the challenges that Congress has had in working through this complex issue, and we appreciate the opportunity to address you today.

In New York, we value our antiques and we recognize the opportunity sometimes to take them off the shelf and dust them off, and Congress is to be praised for having the vision and fortitude to direct USDA to change the rules by which price discovery is accomplished in the dairy industry and effectively consolidating a still vital and relevant Federal milk marketing order system. Simply put, milk remains a perishable product which is difficult to value and orderly market. The Federal milk market order system accomplishes those tasks. Effective price discovery mechanisms and the orderly marketing of milk are two essential components of a healthy dairy industry nationwide and certainly in New York.

Milk and dairy products are New York's leading agricultural commodities and are processed by leaders in the cheese and soft dairy products industry. Production in 1998 totaled 11.7-billion pounds with a value of $1.8 billion and that was 56-percent of our total farm gate sales which are just over $3 billion. We have 8,000-

dairy producers and 140-dairy processing plants. These statistics hopefully show you the importance of dairy to New York's economy.

Besides being the third largest producer in the U.S., New York is a part of a regional block of producers that provides the east coast with dairy products from Maine to Washington, DC. That percentage is about 20-percent of the Nation's milk supply. Our resources are plentiful as they are in the Midwest: water, good soils, and a cool climate. Our farmers are progressive and our industry is well positioned for the future. We have an advantage in our proximity to major markets. The richest market in the world is a 750-mile circle centered in New York state. Within this region, you will find half of the United States and Canada's population, personal income and wholesale and retail trade.

The state of dairy farming in New York is one of a dynamic industry, one that is poised to use these advantages competitively in the new millennium. Our dairy farmers tell me that the regional future looks very promising. However, they need some short-term help while they position themselves in the new volatile dairy environment. Policy tools exist that Congress can provide to help our family farms transition and react to changing conditions in what is a very competitive marketplace.

One of those tools is obviously the dairy compact and it should be expanded to reflect the regional nature of our market. The low prices our farmers are currently facing is the most pressing issue ahead of them right now as prices are at their lowest level in 20-years. The Class III price, the new benchmark price, was announced on Friday at $10.05 a hundredweight. Now forecasters predict that, that price will increase slightly later in the year. However, I do not believe that some more of our dairy farmers can last that long at those price levels.

On January 1 of 2000, the long awaited Federal reform was finally implemented. The three northeastern orders were consolidated into one and after careful review USDA determined that the northeast region should extend from New England to Washington. It would be appropriate for Congress to follow in a similar manner by permitting the Northeast Compact to be extended to cover that region.

Additionally, with regard to the compact, some issues have been articulated about the declining share of the retail price that farmers have. In the compact region, the compact provides a tool for increasing that share of the farmer's price. Some concerns have been articulated by this panel this morning about fluctuations in price. In the compact region, those fluctuations in price have been blunted.

At this panel this morning, there was some concerns about the compact being a trade barrier. My state is not a member of the compact currently. However, a thousand of my dairy farmers participate within the compact region. Clearly, there is no trade barrier for those producers.

With regard to additional tools that could be offered, we would call on USDA to use their authority through the Commodity Credit Corporation to directly assist and increase purchases of cheese and other commodities for school lunch programs. Additionally, it would have been thoughtful for the USDA to use the 125-million appropriated by this committee to address the butter-powder price tilt to support nonfat dry milk at a higher level. This also would have supported the price nationwide.

I additionally applaud you and Congress for directing USDA to hold hearings on the Class III pricing formulas under Federal milk market orders. This is an important and time sensitive issue that impacts all dairy farmers nationwide. I would also ask that Keith Collins, if possible, enter into testimony the information collected by USDA on the mailbox price survey for prices paid to farmers from all over the Nation. What I think that survey will show is that the price disparities articulated at this table this morning might not be so profound and actually might be a little bit different than what has been articulated.

We continue to need Congress' help in providing tools as we transition our dairy industries, and in closing I should mention that I was raised on a dairy farm. I have two brothers still operating farms in western New York. Dairy farming is something I am close to and it is a part of me. It is also an intrinsic part of the rural landscape culture and heritage of New York state. It is because of this importance that Governor Pataki and I have worked so hard and so closely with our congressional delegation in New York to see New York join the Northeast Compact.

If New York is not permitted to join the compact, then our continued efforts to transition farmers to be more market oriented and able to succeed in the new dairy economy will be much more difficult. I hope these discussions today can lead us to the goal of helping our farmers succeed and we can have healthy prospering dairy operations throughout New York and the United States. Thank you again, Senator Lugar, and the rest of the Committee for inviting me here to testify today and I look forward to working with you as we address the issues that face our dairy industry.

[The prepared statement of Mr. Rudgers can be found in the appendix on page 102.]

The CHAIRMAN. Thank you very much, Commissioner Rudgers. Let me just say that in structuring the hearing this morning because of a large number of our colleagues from the Senate, the House, as well as the distinguished governor of Wisconsin and the commissioner from New York, the Chair made an arbitrary decision that I hope was fair and that was that we not get into cross-examination among yourselves. That is a mini-Senate debate as you were offering direct testimony quite apart from a mini-Senate debate with us at this point.

Often when we do have congressional witnesses, and there are a few of them, and they are the major cause, why we have had dialogue back and forth, but it seemed to me given the importance of the issue, the number of witnesses in addition to all of yourselves that we want to deal with, we thought we would ask you to testify for 5-minutes each, offer your full testimony for the record that we will digest, and it could very well be that members of our committee will want to interrogate you personally or by correspondence as they have further questions. The issue clearly will not be resolved today. We will all be back together, I suspect, in one form of another. But I very much appreciate your coming and giving us this time this morning.

Senator JEFFORDS. Mr. Chairman.

The CHAIRMAN. Yes.

Senator JEFFORDS. Could I have 30-seconds on a couple of things that were raised?

The CHAIRMAN. Of course.

Senator JEFFORDS. Now, first of all, the compact was put in sort of as a demonstration program. At least, as you know, I was the one that worked this deal out.

The CHAIRMAN. Yes.

Senator JEFFORDS. To see whether it worked. Well, it has worked. So I think to say it should end now because it was that kind of a program when it works you ought to be improving on it. second, OMB was requested to do a study of the compact by the Midwest and they came back and found there were no increase in the cost of Federal food programs. There is some testimony to the contrary on that. I wanted just to bring that up.

And second, New England is a negative producer as the last witness pointed out and Wisconsin could ship milk down to there now. Of course, as we saw with the evidence we put on, it would end up probably having over $2.00 a gallon a milk versus $1.39. So just thank you, Mr. Chairman.

The CHAIRMAN. All right. Well, we will have at least an equal rebuttal then from, yes, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. The Senator is pointing out that dairy producers within compact states are benefiting from the compact. We will stipulate to that. That is not the issue. The issue instead is how it is benefiting producers and consumers all around the Nation. I think the evidence is pretty clear that we are suffering as a result. And with respect to whether or not there are trade barriers as a result of the compacts, I suppose it was legally true that OPEC nations could purchase oil from the U.S. However, I would doubt that would be the case given the advantage that their cartel had given them and the same thing is true with compacts: maybe not a legal barrier to the entry of our products but clearly with the forces and restrictions within those compacts, it put outside states' producers at a tremendous disadvantage.

The CHAIRMAN. Thank you. Having announced the rule and now having violated it twice———

[Laughter.]

The CHAIRMAN.—still that was a useful exchange and I just trust the members will know that we will try to weigh as carefully as possible.

Senator JEFFORDS. I would like to go back———

The CHAIRMAN. Thank you very much for coming. Before I call Keith Collins, our next witness before us, let me ask the distinguished Ranking Member if he has any opening comment or statement?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, RANKING MEMBER, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator HARKIN. Mr. Chairman, thank you very much. I have been reading the testimony and am delighted to listen to the witnesses. I am sorry I was late. I had a couple of prearranged meetings I had to go to this morning. But I just want to note for the record that from I believe 1980 to 1984 I was chairman of the Livestock, Dairy and Poultry Subcommittee on the House Agriculture Committee. All I can say is I am sure glad we got this dairy thing worked out at that time so we are not having any problems with it today.

But some of these problems have been around for a long time. I also want to say, Mr. Chairman, in case I have to leave I know the Indiana Professional Dairy Producers are up. I was reading their testimony and Mr. Yoder here had this statement here. He said it is no secret that how milk is priced is the second-greatest mystery known to man. I take issue with that. It is the greatest mystery known to man, not the second.

And I also wanted to, for the record, note that—well, now I lost his testimony—one of the individuals from Wisconsin put the formula in the back of his statement. I recommend it to everyone—to work out—again, I forget who that was. Anyway, one of the congressmen from Wisconsin had the formula in the back for how you get the basic price for milk.

Mr. Chairman, I did want to correct one other—just say one thing about some of the statements that were made that, well, would you price computers how far they are from Seattle or oranges from Florida or beer from St. Louis, Anheuser–Busch? Well, milk is different. I mean, you know, if you are producing too many computers, you can slow down the line, you can lay a few people off and slow it down a little bit. You do not have to produce that many. You cannot slow down a cow, you know, it just produces milk, and you just cannot quite slow it down. I suppose you could feed it a little bit less, I suppose. But you really cannot slow it down.

And what the heck, I might as well state again for the record that last summer I bought some beer. I stored it in the refrigerator. I opened one the other day and it is still good. You know so beer can stay for a long time in your basement and milk cannot.

And third, there is a value to the consumption of milk for healthy bodies and for kids. Like I said, we have been through these debates before. Looking back, I think what should have been done a long time ago was two things. One, basic formula price for milk should have been based on solids, not fat. It should have been done a long time ago. Dairy industry was way behind the eightball in this, way behind it. Consumers are moving ahead. They did not want to consume so much fat. And they wanted a more high protein product and yet we continued to base it on butterfat content. Well, now they have changed it a little bit. They now include proteins and lactose and some other things in the price, but way too late.

And second, we should have had a two-tier pricing formula a long time ago. Congressman Gephardt and I proposed that in the mid-1980s. I proposed it earlier on. We fought for it. We never got it. But I think if we had had a two-tier pricing formula in existence for the last 10-years, 15-years, I do not think we would be where we are today. The marketing orders are outdated in many ways. We can transport milk more rapidly. I do understand that there is a problem. Senator Jeffords said it appropriately. I mean if you are transporting it halfway across the country, obviously it is going to cost more for consumers in one part than it is in another part.

Well, maybe yes, maybe no. Again, it depends upon how you price it and just how far you have to transport it. But it may be a little bit more costly, but there are ways of getting around that, too. So, Mr. Chairman, there are a lot of cross-currents in this whole dairy policy, and it has become one of the most bitter regional conflicts that we face today. We do need some common ground. I hope we can find an equitable, fair and sustainable national dairy policy, one that is good for farmers and fair to consumers and processors, and so again I still believe there should be an adequate safety net.

There is in the Northeast now. There is a safety net for the dairy farmers in the Northeast. But there is not out our way. So there should be a better safety net. So I hope that we can find some way to end the unfair regional preferences that we have in dairy policy today and move ahead with some equitable system. Like I said, I think there are some things in the past that we could take a look at that might be more equitable than marketing orders are today. And there may be some way of taking care and addressing the problem of transportation of fluid milk to deficient areas and that might be cheaper in the long run than keeping this outdated, antiquated marketing order system going.

So Mr. Chairman, I congratulate you for calling these hearings. This is a byzantine area and it is, as I said, it just has provoked, as you know, just a lot of regional conflicts in the Senate and it cross-currents. It is not Democrat or Republican. It just flows across all kinds of different lines, and I hope through these hearings we could hopefully find some equitable solution. Thank you, Mr. Chairman.

[The prepared statement of Senator Harkin can be found in the appendix on page 108.]

The CHAIRMAN. Thank you very much, Senator Harkin. Senator Santorum, do you have a comment?

STATEMENT OF HON. RICK SANTORUM, A U.S. SENATOR FROM PENNSYLVANIA

Senator SANTORUM. Very briefly, Mr. Chairman. Just let me thank you for holding these hearings. There is probably no issue in my state that, as Senator Specter, I am sure, testified to, has gotten more concern and more angst not just among dairy farmers but among all of us in rural Pennsylvania. As I always say here on the ag committee and rural affairs committee, we have the largest rural population of any state in the country in Pennsylvania and we are the fourth largest dairy producing state. Agriculture is the number one industry in Pennsylvania and dairy is the number one industry within agriculture.

And so this is an incredibly important issue, not just to our dairy farmers, but to all of rural Pennsylvania, and I listened with great interest to what Senator Harkin just referred to as these incredible cross currents as we see in this industry. And listening to some of the congressmen from Wisconsin talking about how much their dairy farmers are hurting, I will match my hurt in my dairy farmers with your hurt in your dairy farmers any day, and it is not just in Wisconsin or the Midwest. Our folks are hurting, too. And we have on top of that the problems with drought last year which has made it even tougher for our folks and I will remind my colleagues we did not do very much on drought relief last year, as my farmers are going into the FSA office and being told they are going to get 30-cents on the dollar when some folks across the country are getting double Agricultural Market Transition Act [AMTA] payments and gosh knows what else in support, and my folks have no crops to sell, have low dairy prices, and are getting a pittance for relief.

So I think we have some more work to do on that front, but obviously on the fundamental look at dairy and how we can structure a system that can provide stability as well as a solid price is something that we should strive to attain. I thank the Chairman for looking into this.

[The prepared statement of Senator Santorum can be found in the appendix on page 110.]

The CHAIRMAN. Thank you very much, Senator Santorum.

Keith Collins, always good to have you, a fount of wisdom and good counsel for the Committee. You have heard already a number of distinguished witnesses. So you may take almost any position you want and at least find some support here today. But thank you for coming and we will give you 10-minutes or whatever is reasonable because I know Senators will have questions of you after you conclude. We are glad to have you, Mr. Salathe, with Keith Collins. Please, proceed.

STATEMENT OF KEITH COLLINS, CHIEF ECONOMIST, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC., ACCOMPANIED BY LARRY SALATHE, SENIOR ECONOMIST, USDA

Mr. COLLINS. Thank you very much, Mr. Chairman and Mr. Harkin and Mr. Santorum. On behalf of USDA, I want to thank you for again inviting me up here to participate in this review of dairy policy—always a challenge, a challenge that we welcome today. My task this morning, my invitation asked me to explain and to review the major Federal dairy programs concentrating on their economic effects and also to offer a couple of thoughts on the coming year for dairy to provide a context in which dairy policy will operate.

Dairy policy has had a lot of objectives over the years. They have ranged from ensuring adequate supplies of milk to protecting farm income to expanding demand, just to name a few. Well, when you have many objectives, sometimes the consequence of that is many programs and we have many Federal programs that affect dairy which I think should be considered when you think about the Federal role in dairy policy. We have the price support program. We have the marketing order program. We have the compact, dairy export incentive program, checkoff programs, and the the loan and payment programs. I would point out that, for example, in the year 2000, we estimate that the average dairy farm business in the United States will receive about $6,000 in direct government payments from these programs.

We also have import controls. We have food and nutrition assistance programs. We have research and extension programs and all of these things have to be considered as a package when thinking about Federal dairy policy. Having said that, because you were kind enough to give me 10-minutes, I am just going to focus on two of these programs, which are mainly the price support program and the Federal milk marketing order program.

Well, prior to 1981, we had milk price support levels tied to parity and generally they trended up. In the 1980s, late 1970s, and early 1980s, we started to see very strong productivity gains in milk combined with the firm price support floor. The result of that was we saw increasingly imbalanced and unsustainable dairy markets. Congress, as a result of that, trying to restore balance to these markets, did several things. They implemented supply controls in the 1980s for milk. They implemented producer assessments and they lowered the price support level. In fact, between 1981 and 1990, the price support level was reduced about 25-percent.

The result was that when you look at the price support program in the 1990s, you see a program that has operated very differently than had operated during the 1980s. In the 1980s, we had year after year after year of billion dollar costs in the program. The record was $2.5 billion in 1983. But by the time we get to the mid-1990s, 1995, the cost of the dairy price support program is basically zero. Government stockpiles, the legendary caves were gone, and disposal programs had largely disappeared.

However, one consequence of this is that producers have faced greater price variability as the lower support level has permitted market forces to operate over a much wider price range. The price support program thus has gone from being quite distortionary in the 1980s with very pronounced economic consequences to being pretty benign by the mid-1990s. Over the past couple of years, however, we have seen the role of price support start to pick up, as we have started to buy more nonfat dry milk, and most recently the price of cheese has fallen to near support.

If we look out to the year 2001 when the price support program is expected to terminate, we think that without the program, the annual average all-milk price would decline 35- to 55-cents a hundredweight or about three to 4-percent. Because of the income support the price support program is now providing, the administration has proposed extending the price support program through the year 2002.

Tomorrow we have a couple of USDA staff that will be reporting to you on Federal milk marketing orders. They run the program. So I am not going to say too much about orders, but I want to give a couple of thoughts on their general effects. And I think it is helpful to contrast the price support program with the Federal milk marketing order program. The price support program reduces the available market supply of butter, cheese and nonfat dry milk because the Government purchases the product and takes it off the market.

Now that pushes up the price of those products. It pushes up the price of the milk that is used to manufacture those products. The price is higher than it would otherwise be. This also pushes up the price of fluid milk because, of course, the minimum Class I price, the Federal order price of fluid milk, is tied to the price of manufacturing milk. So the price support program at least temporarily raises the whole spectrum of dairy product and milk prices, and it does it in all regions of the United States.

Federal orders have very different effects. If Federal orders raised prices above competitive levels in one use or in one region of the country, prices would decline in another use or another region of the country. This has to happen because Federal orders do not have supply controls. So the national supply and demand for milk must balance. Orders establish minimum prices for milk in four uses with Class I being the minimum for fluid products. And the Class I prices, of course, vary by location.

Now suppose that USDA does not have it right. Suppose we do not have the right Class I differential, and by that I mean suppose in an order we set a differential that is higher than a differential that would prevail in a freely competitive market. Then the price of fluid milk is being supported in that region. The higher fluid price reduces fluid consumption which makes more milk available for manufactured uses and reduces the price of milk for manufactured uses.

If an order has a higher proportion of its milk going into Class I use, then the average producer price would be higher than in a freely competitive market. And that would encourage milk production. If a low proportion of milk is going into Class I use, then the average price, or the blend price, would be pulled down by the lower manufactured price, and that would discourage milk production relative to a freely competitive market.

So the whole debate about Federal milk marketing orders and its economic effects and whether they are distortive or not, I think, really comes down to whether the Federal order minimum Class I price is supporting the Class I price or not in markets across the United States. Well, what do economists think about that? I think they think this occurs to some degree, not a huge degree, but that it occurs. A review of economic studies suggests that nationally farm level milk prices would decline by 1- to 3-percent in the absence of Federal orders with U.S. farm income and consumer expenditures on dairy products falling by a parallel amount.

However, producers in markets where Class I use is high would see larger price declines and producers in areas where Class I milk is low could actually see a price increase. In the last year the Secretary reached the same conclusion and concluded that Class I differentials were unduly high in some regions and too low in others and proposed lowering the Class I differential on average in the United States from $2.57 per hundredweight down to $2.28 per hundredweight. That was a 29-cent per hundredweight decline that was proposed. Well, we all know the fate of that proposal.

I would like to point out that despite widespread concern that the Secretary's proposal was going to reduce the average blend price to producers, we have gone back and calculated what that price would have been over the last 18-months using the data which is available starting in September of 1998. And the Federal order blend price would have averaged about 20-cents a hundredweight higher under the Secretary's proposal had that been in effect since September.

Well, a comment on dairy compacts. I think they essentially have the same general effects as Federal orders. They raise farmers' incomes by trying to raise the price of milk used in fluid products. Studies have indicated that resulting higher production in a compact area leads to more milk production and higher retail prices for fluid milk consumption. This makes more milk available for manufacturing uses, pushes down prices for those products and prices to producers marketing outside the compact. And the adverse effects on producers outside the compact would be amplified as more states were to join a compact.

Let me conclude with a couple of comments about the financial condition of dairy farmers. We have seen quite a price collapse in the last couple of months with the Basic formula price [BFP] in November and December reaching 21-year lows. Fortunately, record high milk prices this past marketing year and low feed costs have put most dairy farmers on a fairly solid financial footing going into the year 2000. We estimate that 11-percent of dairy farm businesses were having debt repayment problems by the end of 1998. That compares with 22-percent for all farm businesses. Lower milk prices this year we think could increase those debt repayment problems to about 17-percent by the end of this year.

Structural adjustment in the dairy industry continues with no end in sight. In 1999, the number of operations having milk cows dropped 5-percent from 117,000 to 111,000. That continues the long-term trend. Over one-half of all dairy farms have fewer than 50-cows and their numbers dropped by 8-percent. Two-percent of all dairy farms have more than 500-cows. And their numbers increased by 6-percent. And milk production continues to expand rapidly in the West supported by favorable weather and forage availability.

It is hard to see how dairy programs or market conditions will have much effect on these structural trends over the next few years. And that concludes my comments. We would be happy to take any questions.

[The prepared statement of Mr. Collins, can be found in the appendix on page 112.]

The CHAIRMAN. Thank you very much, Mr. Collins. Let me just pick up where you left off. You point out in your testimony that in the past decade, milk production increased about 1.2-percent a year. Production per cow increased about 2.2-percent a year during the decade while milk cow numbers declined about 1-percent per year. And you point out that this year we are now in, however, would be the second largest percentage increase in milk production during the decade of the 1990s surpassed only by last year's 3-percent increase, a sizable increase last year and this year, as distinct from pretty level lie for the previous years in the decade.

Having said that, you also point out that dairy farms improved their financial positions in 1998 and 1999 and that concentrated expenses dropped 10-percent in 1998 and further in 1999. A drop in feed costs likewise. So this has led, by and large, and this is always the problem of average statistics because the problems of those who are in trouble are not average, but you point out that farms with gross sales of 50,000 or more averaged—the income, cash income—averaged 95,000 in 1998 and in 1999 compared with 1994–98 average of 64,800.

Now the net cash income of dairy farms this year, you think may fall by 21-percent to 74,900. But as you are pointing out, in comparison to all of agriculture, the debt structure problems for dairy farms appear to be substantially less, although given this year 2000 situation they might increase. And as you pointed out, the number of dairy farms total has been in decline throughout this century, perhaps for two centuries, as has been the case with corn farms, soybean farms or whatever. Thus, confirming a higher degree of concentration.

You pointed out the larger cow situation has gone up by 6-percent and other situations declined by 8. That is the smaller. Now taking a look at this whole situation, the Cato Institute, to be the devil's advocate for a moment, suggested that about $400 million is transferred from the general public consumers to the dairy industry, whatever the size might be of the farms or whatever the configuration of our programs, by the marketing orders or the supports that you have described.

In other words, a transfer payment of consumers to dairymen, however many there are, 400-million a year. Now earlier this morning we heard a contention that within this $400 million of support from taxpayers, about 145-million transfers to the New England situation away from everybody else so that, as you pointed out, it is a fairly stable pie, whatever it may be, but the pieces are redistributed through the politics and the polls of this situation.

First of all, do you believe that the Cato Institute's idea that essentially the rest of the taxpayers of the country are supporting dairymen by 400-million is correct, and is the transfer to New England from the rest of that size, and if not, can you give us any idea of the proportions of these shifts?

Mr. COLLINS. First of all, I would say that the Cato Institute study was really a summary of other people's work and it is consistent with the one to 3-percent I mentioned.

The CHAIRMAN. In other words, the programs themselves probably increased dairy income by one to 3-percent?

Mr. COLLINS. Right. I indicated that the national average all milk price might be 1- to 3-percent lower without orders, sort of a summary conclusion from lots of studies. One to 3-percent would be about a—the midpoint would be about a $500 million increase in consumer expenditure or a $500 million increase in farm income.

The CHAIRMAN. Stated another way, if you had no programs, no dairy programs, we had free market, consumers would pay 1-percent to 3-percent less for milk on average throughout America?

Mr. COLLINS. Yes, that is sort of a general finding. So that would be consistent with the Cato study. Apart from that, there are also the effects of the dairy price support program, which actually right now and over the next year or so would probably be greater, I think, than the effects of the milk marketing order program.

The CHAIRMAN. In other words, they increase production?

Mr. COLLINS. They will increase production. They will have a larger effect on the all-milk price than the Federal milk marketing order program would in the aggregate across the Nation.

Now regarding the compact, I cannot really tell you. I have not done a calculation on what the distribution of the gains are by different regions of the country due to the compact over-order price.

That, of course, varies from month to month. Since the compact was first implemented, and they established a minimum $16.94 per hundredweight price on Class I milk. That was a fair amount above the Federal order minimum Class I price. Then as time went on and milk prices got stronger, of course, that difference dissipated. As the difference dissipates, then there is no differential effect of the compact. So the effect sort of depends on looking at prices over a period of time and I have not done such a calculation.

The CHAIRMAN. Has anyone done so? Obviously, this is a part of our debate as you heard this morning. It was described as a regional dispute with winners and losers.

Mr. COLLINS. I would let Dr. Salathe respond, who I might say has assiduously spent a career at USDA decoding Federal dairy programs for their effect on consumers, producers and taxpayers.

The CHAIRMAN. Well, give us the benefit of your wisdom.

Mr. COLLINS. So I will let him take a shot at that.

Mr. SALATHE. Well, I will try to live up to that. But I would refer back to the OMB study that was done and looked at the period from July 1997 through the end of 1997. That study basically indicated that if you looked outside the compact, the effect was fairly small at that time. And the all-milk price outside the compact was probably reduced about 2-cents a hundredweight which if you multiply that by milk production outside the compact would come to on the order of about $30 to $40 million. Now that is just for that second half of 1997.

The CHAIRMAN. So the losses to the people outside the compact you think were 30- to 40-million———

Mr. SALATHE. Yes.

The CHAIRMAN.—on an annual basis?

Mr. SALATHE. Right.

Mr. COLLINS. And then there would be whatever consumers in New England had to pay for higher fluid milk as a result of the compact. That would be another transfer.

Senator LEAHY. Well, wait a minute. Consumers, the record will show, Mr. Chairman—I do not want to let that one just slip through here—in the compact, consumers are paying a lot less for their milk in New England than they are in Minnesota and Wisconsin and these places that object to the compact. I mean that is, as GAO has found, that is an absolute fact.

Mr. COLLINS. There is no disputing that. I think the question for economic analysis is what would the price of fluid milk be in New England with and without the compact? Not so much how it compares with other regions of the country. And I think there have been studies that have shown that there is an effect, an increase in the price of milk in New England as a result of the compact.

Senator LEAHY. Mr. Chairman, I find this—and I am sorry to butt in on your time—but I mean these are the kind of misstatements we keep getting on this. There is an objective report done requested by the, primarily by those who were opposed to the compact, and it came back that milk costs less in the compact area than it does in places like Minnesota and Wisconsin where they do not have a compact.

The CHAIRMAN. Well, that point apparently is not in dispute, you know, without trying to mediate between the Senator and the witness.

Senator LEAHY. I understand. I apologize.

The CHAIRMAN. But the question is even low as the prices are in New England, would they be lower still without the compact, at least as I understand the issue with economists? So that is my understanding. Now, let me just ask one final question and that is policy wise why do we have a dairy program? In other words, last year a distinguished colleague in the House, Congressman Boehner, offered legislation, as I understand, simply to terminate all of this so we would not need to have any more debate. People just simply would sell milk in a free market situation without need for either compacts, marketing orders, supports, Eau Claire and distances or all the rest. As a matter of policy, why do you support, or if you do, a program at all?

Mr. COLLINS. I try not to support or not support anything, just to comment on their effects. I would say that the answer to that question obviously is an economic, political, and social collection of reasons for having programs. From the economic point of view, you trade off the effects on consumers or economic efficiency against the gains you are providing to producers. And the political system has decided that those benefits to producers outweigh those other effects and so that is why we have the program. Effectively, the gains to produce from a price support program would be higher prices than would otherwise be the case when markets are weak, some measure of stability provided to prices for producers. It prevents prices from falling to unduly low levels that might not prevail in the longer term and therefore keep people from going out of business that might be able to persist in business if the prices were prevented from falling to those levels that we know they are not going to stay at. So I think that is a strong reason for the price support program that the political system has recognized.

I think with respect to milk marketing orders, part of its rationale goes back to Senator Harkin's comment about distinguishing between the perishability of fluid milk plus the durability and the storability of manufactured products and the need to ensure an adequate supply of fluid milk in fluid milk markets, understanding that there is seasonality in production and seasonality in demand that do not match up.

The free market system would provide a pattern of differential prices across the United States: higher prices for Class I use because much Class I use takes place in metropolitan areas like Boston, New York, Philadelphia and so on. The milk obviously is not going to be produced there; it is going to be shipped in, there are going to be transportation costs. As economists say, the elasticity of demand for Class I milk is very inelastic and so there is going to be a higher value to that milk and that would occur in a free market. And so the order system in imposing minimum differentials is in some sense mimicking what might occur in a free market system.

So then the question becomes, well, if the free market would provide this pattern of differentiated prices and provide the incentives to move milk, why do you have to have the Federal Government ensure that minimum? And I think there the question gets into very difficult issues to evaluate such as balance of competitive power and negotiation between dairy producers and dairy processors.Does the order system help producers compete with concentrated processing markets?

Another example I think that is probably more cogent is this question of balancing fluid needs. Because the seasonality of production, and the seasonality of demand differ, you are going to have a draw for milk into fluid uses for fluid processors at certain times. Needs are going to swing up and down. If you happen to be a producer that lives close to the fluid bottling plant, then maybe all of your milk 100-percent of the time will go to that fluid bottling plant, but if you live further away, then when the fluid plant needs extra milk, your milk will get pulled in. When the fluid plant does not need extra milk, then your milk is going to go to some manufacturing plant for a much lower value. And so this person that lives a further bit away is, in effect, paying the costs of balancing the fluid milk market.

So the order system is an attempt to have everyone share in those costs and have everyone share in the higher value that comes from the Class I use. So that Class I differential that is paid by a processor goes into a pool and is paid out to everyone including the person who is performing the balancing function. So there is a lot of things going on in Federal milk marketing systems that have to be weighed, and I think it is because of this whole constellation of effects that take place that the administration and Congress have continued the system.

The CHAIRMAN. I thank you for that comprehensive answer. It is a very important part of our testimony and I appreciate that excellent summary. Now I am going to ask each Senator to try to take only 5-minutes in the first round and if there are additional comments and questions, we will have a second round. I call now upon my distinguished ranking member, Senator Harkin.

Senator HARKIN. I thank you, Mr. Chairman. And I appreciated that last question you asked and the response from Mr. Collins. Those of us who have been through this for the last, as you have been, for I do know not how many years recognize that there is an imbalance. I mean most milk production is in the spring, the spring flush. The biggest demand is in the fall and the winter. Most people buy their milk on the weekends, but cows do not just wait till the weekend to produce the milk. They do it everyday and so you have got not only weekly fluctuations, you have got annual fluctuations.

And the dairy price support program if it does cost one to 3-cents more, 3-percent more as the Cato Institute said, I figured that would add to half a gallon of milk probably about a penny, maybe 2-cents at the most, $1.89, about 2-cents maybe. How much then would that milk fluctuate to the consumer if we did not have such an order and in the springtime, yeah, a consumer might buy milk pretty cheap in the spring, but wait till next winter. You are going to get stuck for higher prices. So I am just saying that on an annualized basis, the consumer is probably spending less under the system of orders than they would if we had this sort of total free market.

I am just saying that. I do not know. Because you are going to get spikes in prices in the wintertime even though you might have lower prices in the spring. I just think on an annualized basis. Plus it is a more stable price. You could see this if you just opened the doors and did away with everything, you could see milk in the spring. You could probably buy it for almost nothing. Wintertime you would pay through the nose for it.

So I think there is some need for stability in the system. Having said that, do I believe that we do not need to change the system. I am not saying that at all. I think perhaps the recent action of reducing the number of orders was probably well overdue. It perhaps could be reduced even further. I do not know. We could look at that. In terms of the compacts, with all due regard to my good friend from Vermont, I am not certain that the compacts really are benefiting the entire Nation in terms of milk production and milk pricing. And it could lead to a whole regionalization of the whole milk thing and we will be back where we were before.

While my good friend from Vermont is right that the price is cheaper than it is in Minnesota and in Wisconsin, I am not certain that the consumers in that area of the country would not be better served without the compact in terms of their overall prices. And the steady price at which they pay on an annualized basis. Mr. Chairman, thank you very much.

The CHAIRMAN. Well, thank you very much, Senator Harkin. Senator Craig.

STATEMENT OF HON. LARRY E. CRAIG, A U.S. SENATOR FROM IDAHO

Senator CRAIG. Mr. Chairman, let me ask unanimous consent that my statement become a part of the record.

The CHAIRMAN. It will be published in full.

Senator CRAIG. And I thank you very much for building a record on this issue. I think it is continually important as the Northeast Compact has stayed in place for a time, I think we are going to get a better evaluation of the market and how the producer and the consumer reacts to it than we have had. And gentlemen, let me thank you for your testimony.

Mr. Collins, when you examine inside the Northeastern Compact the stability of the producer, is the attrition or the change in production any different than it was prior to the implementation of the compact? I mean dairies going out of business, size of dairy scopes, that kind of thing. Have you spent any time looking at that?

Mr. COLLINS. I have not, but there has been a recent study that was done and issued in November of 1999 that looked at that. Unfortunately, I do not recall the result. Do you, Larry?

Mr. SALATHE. Well, we have looked at the number of farms with milk cows in the compact area since 1997 through 1999, and basically it shows a similar pattern outside the compact as well: declining number of small farms, farms with 50-cows or less, and increasing numbers of farms with 200-cows or more.

Senator CRAIG. Yeah. Well, that has been my understanding. The mantra here was to save the family dairy farmer and while those larger dairy farms may be family or family business oriented, my guess is you do not save the small farmer by creating artificial kinds of marketplace involvements and my guess is it is not happening from what I understand in the Northeast. And I think that my colleague from Vermont and I can debate price, but we also cannot compare apples and oranges when we debate price as it relates to what prices would have been for producer and consumer with or without the compact. There are clear records of reality forces that deal with the price in the northeast and what it is today versus what it was. And I think that is what we can argue if that becomes an argument. There are plenty of studies out there that I think justify that.

The reason obviously I am sensitive to dairy—a lot of people do not think of Idaho as a dairy state. We think of Wisconsin and we think of the Northeast and Minnesota. Well, we are now sixth, headed for fifth, in production in the Nation. Obviously, the dairies of my state are large dairies and growing larger. We now have 5,000-cow units out there. We milk around the clock. We produce cheese and manufactured products around the clock. There is a whole dynamic in the West that is significantly different than the East and so the marketplace is important and policy program here is important.

Let me thank you for your testimony, and Mr. Chairman, let me say that I wanted to recognize—I think I will be able to stay, but in your next panel, we have Dennis Vanderstelt, who is president of the Western States Dairy Producers Trade Association from my state of Idaho, a producer from the Kuna area. I am pleased that you have allowed us to help you shape a broad base of those who come to testify because I think it is clearly important that as we look at this industry and our policy that we hopefully will emerge out of regionalism into the reality of a marketplace and our policy will reflect that. Thank you.

The CHAIRMAN. Well, I thank the Senator for his suggestion of the witness. We look forward to hearing from the distinguished citizen from Idaho. Senator Leahy.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

Senator LEAHY. I would say to the distinguished Senator from Idaho, if you would to have it totally on the market, does that mean that we in the East would no longer have to subsidize water and all throughout the West as we have for———

Senator CRAIG. Well, it is our water out there. We do not need you to subsidize it.

Senator LEAHY.—for decades. And, of course, they have paid every cent of the dams, the river changes and all the rest, but that is theirs. Mr. Collins, of course, continually ignores the fact that if we get rid of the compact, 30- to 40-percent of the farmers in Vermont and New England would probably go out of business, which, of course, would raise the prices very substantially.

But it is a good thing, though, to have this hearing, Mr. Chairman. I am a person who believes in inclusive, and it was so great to see all the people you brought together here. These poor folks from some of the dairy processors, you know, just, I mean they have to spend all the money to take a cab or a limousine or whatever to come here to the Hill. I do think one thing about the compact. It does bring people together. It is the one thing that Mrs. Clinton and Rudy Juliani both agree on and so I think possibly there is hope for both of them in that regard.

But in dairy farms, dairy families, it is a serious topic and I do not want dairy farmers in Minnesota, Wisconsin, and Mississippi or Iowa, North Carolina or Idaho or Vermont or anywhere else to go out of business. I will say this to everybody. I will support, I will vote for, as I have, a reasonable legislation that helps the dairy farmers in each of those places and I will work with any region of the country. But back in my office I have got this huge stack of diatribes against the dairy contract. Scores of charges were made before the compact legislation was passed the first time. Notwithstanding the official view or even the official view of neutrality from the USDA and the administration, there are those in the Department of Agriculture who worked every single day to try to defeat it even though they are told to do otherwise by their bosses.

But they were wrong and the compact has gone on to do just what we said it would do. So let me just talk about some of the myths, some of the euthanistic language. Here is number ten: Compacts are designed to bar dairy products from outside the state or region. Well, anybody can sell into the compact area. In fact, New York, which is not part of the compact area gets about a quarter of all the compact's payments. So it shows that it does not bar anybody.

One of they myths: the compact is more terrifying than the Blair Witch Project. I have not seen the Blair Witch Project, but I understand it made a lot of money, as do the lobbyists who now use it. But it adds 50-cents to one dollar to the price of milk. Well, the only thing more terrifying I guess than the Blair Witch Project is milk prices in Minnesota and Wisconsin, which the GAO reports are often much higher than the Northeast, and as they show the Northeast prices are on the average less than other parts of the country.

Or they say the compact is a milk tax. And thus it hurts the School Lunch Program and WIC. Well, in fact, the School Lunch Program and WIC are exempt from the compact. They are not exempt from the high milk prices in the Midwest and maybe, Mr. Chairman, we should find out why it is in the Midwest that the WIC programs are paying so much more than we are. I hope we are not going back to the kind of price fixing we saw on the WIC program a few years ago, but it something we can look at.

They say the compact has dramatic effects and impacts upon price of farmers in other areas, especially in the Upper Midwest. Well, OMB reports that the compact region which produces only 2.9-percent of the fluid milk in the Nation has little effect on dairy markets outside its region or national prices and trends. In fact, once it was put in place, Wisconsin had about a 2-percent increase.

Production is expanded beyond the compact region's fluid needs, they say. Well, production in New England is tied to our needs unlike in the Midwest where there is about 85-percent overproduction and has to go to other needs.

And this, Mr. Collins, I just thought I would mention to you. We have been told the Secretary of Agriculture opposes the compact. Could have fooled me. He twice approved the compact and he signed its charter. I do not know if that word has gotten down throughout out beyond his office and sometimes the reaction of some—I am not going to name them—but some who go contrary to what their boss says, they should know that.

The compact helps large dairy farmers more than small ones, we are told. The average—I do not know what the size of a large farm is, but the average size in the compact is 80-cows. The higher prices—they say consumption goes down and children are the biggest losers. Well, milk prices in the compact region are considerably lower than Wisconsin or Minnesota and consumption of milk has increased in the compact area which should be good news for every parent.

And despite what some have argued, the Northeast Dairy Compact has not even helped small northeast farmers, we are told. Well, the Farm Bureau Federation reports significantly below average losses of farms in New England with some compact states reporting actual increases. Just the opposite of the claims that have been made.

And then last, let me tell you about this. We had—I am sorry, Mr. Chairman, I am taking more of my time, but I will just close with this. We had two ice cream socials here last year. International Dairy Foods Association [IDFA] had their social and were opposed to the compact and showing their usual subtlety, they were then quoted in the press as saying basically that any milk from Vermont or ice cream from Vermont ought to have the name of cow manure. You know it is a kind of, they wanted to make sure that subtly we got the point. Well, I asked our biggest producer of milk, Ben and Jerry's, because I said after all the Ben and Jerry's ice cream social had outdrawn IDFA, and asked them if that was sour grapes. Ben Cohen told me they are always looking for new names, but he found that Chunky Monkey, Fish Food and Jerry Garcia probably sells a little bit better. And so I just wanted to get that on the record.

The CHAIRMAN. I thank the Senator.

Senator LEAHY. Thank you, Mr. Chairman.

[The prepared statement on Senator Leahy can be found in the appendix on page 135.]

The CHAIRMAN. Senator Santorum.

Senator SANTORUM. Thank you, Mr. Chairman. In your statement, you talked about several things you wanted to review but you did not review in your testimony and that is the Export Incentive Program. And one of the things I always talked about to my farmers is, well, there are several things we have to do to improve your prices and one thing is this battle with exports. And up in my end of the country we hear a lot about Canada and the problems we are having there. Can you give us a little bit of a refresher on how we are doing in the export market and whether the Dairy Export Incentive Program [DEIP] program is being helpful or not, and what are the prospects of us expanding our markets in the dairy area?

Mr. COLLINS. I would be happy to, Senator Santorum. On the export side, we are largely not competitive with other countries in the world. Most of world trade is occupied by the United States, Australia, New Zealand and European Union. Together we account for

80-percent or more of trade in each of the major dairy products. Our trade basically exists because of the dairy export incentive program. We do have some specialty cheeses and products like that, that we can export without subsidies, but by and large our subsidy rate under DEIP is roughly 50-percent of the market price which shows you that our prices are way above the world price. So without DEIP we would not be exporting. So DEIP is very important to us exporting.

Under the Uruguay Round agreement, the volume and value of subsidized exports has to decline between 1995 and 2001 with value coming down 36-percent, volume coming down 21-percent. We underutilized our maximum permitted export subsidies in 1996 and 1997 and as a result of that, using the flexibility provisions of the Uruguay Round agreement, we increased our exports the last couple of years. This past year, 1999–2000, we will probably DEIP something on the order of 100,000-tons of nonfat dry milk. Under the terms of the agreement, we can subsidize no more than 68,000-tons next year, the 2000–2001 year, which is the last year of the implementation period. So there will be a substantial dropoff in subsidized exports of nonfat dry, milk which is the principlal DEIP product, if we are to meet our WTO commitments.

Senator SANTORUM. What do you see? How does that impact the price? I mean can you give me a———

Mr. COLLINS. I think somewhere in my statement I had indicated that the total amount of subsidized DEIP exports have about a 30-cent per hundredweight effect on the price of milk. So we are talking about a one-third drop, something in the order of a 10-cent per hundredweight drop in the price of milk nationally as a result of going from where we are this year to where we will have to go next year.

Senator SANTORUM. You made a comment that we have to DEIP our products to sell them because we are 50-percent above the market price?

Mr. COLLINS. That is a rough estimate, yes, somewhere in that neighborhood. I could give you exact figures, but they were quite high.

Senator SANTORUM. How can we be that uncompetitive in the world market?

Mr. COLLINS. Well, we have very rigid tariff rate quotas holding out imports. That helps keep up our price. We have a price support program and the rest of the world consists of the three countries that I mentioned of which Australia and New Zealand are very efficient, low cost producers. I might mention that Australia's production went up 8-percent last year. New Zealand's production we think this year will go up something like 10-percent. These are huge increases when you compare them to our trend growth of 1- to 2-percent. In addition to that, the world is dominated by the European Union which subsidizes enormously to get into world markets.

Senator SANTORUM. My question is we are not uncompetitive vis-a-vis production. We are competitive vis-a-vis subsidies. Is that now———

Mr. COLLINS. Well, I would say studies that compare the cost of production between New Zealand and Australia with the average in the U.S. would show them to be lower, not true for the European Union.

Senator SANTORUM. How much lower?

Mr. COLLINS. Several dollars a hundredweight at least. With respect to other countries that have been significant exporters, like Canada over the last couple of years in cheese and the European Union, they are heavy subsidizers. So there are sort of two factors going on. There are some efficient producers in the world and there are some heavy subsidizers in the world.

If the other competing countries did not subsidize, clearly that would raise the world price of dairy products closer to ours. And just because we are a high cost producer relative to say New Zealand does not mean we would not enjoy exports. You know you can export based on the size of the world market that is out there. A strong and growing world market would accommodate lowest cost producers and highest cost producers, as you move up to fill the needs in the world marketplace. So if we were to ultimately eliminate export subsidies, that would, I think, enormously help our competitive potential in the world market place, but we are a long ways from doing that.

So as we stand here today, our exports are pretty much contingent on the Dairy Export Incentive Program. We are talking about something on a milk equivalent basis for the DEIP program of exporting something like three billion pounds of milk, something in that range, out of the 160-billion that we produce each year. So our exports are not very prominent, but nevertheless they are helpful and they do help support prices.

Senator SANTORUM. But I understand. You recommend getting rid of the DEIP program as a way to improve our opportunity to trade?

Mr. COLLINS. Only multilaterally. I would not recommend it unilaterally.

Senator SANTORUM. OK. Thank you.

The CHAIRMAN. Thank you very much. Senator Fitzgerald.

STATEMENT OF HON. PETER G. FITZGERALD, A U.S. SENATOR FROM ILLINOIS

Senator FITZGERALD. Thank you, Mr. Chairman. Mr. Collins, thank you for your good testimony before our committee.

Mr. COLLINS. Mr. Fitzgerald.

Senator FITZGERALD. Senator Leahy mentioned or pointed out that the Women, Infants and Children's program and the School Lunch programs are exempt from the compact and he therefore said that it was not costing the taxpayers money by adding to the cost for those programs. But it seems to me that there are other Federal nutrition programs out there such as the Food Stamp program. And somebody who is on food stamps, I would imagine when they go to the grocery store, they are just using their electronic benefits card to buy their milk like everybody else. The higher prices that people in those compact states have to pay at the retail level for milk would be passed on to participants in the Food Stamp program. Would that not be correct?

Mr. COLLINS. Absolutely correct, Mr. Fitzgerald.

Senator FITZGERALD. So part of that transfer that we were talking about earlier that the Cato Institute cited, money being transferred from consumers in general to the producers in an effort to make more money for the producers, part of that transfer is occurring from some of the absolute most needy people in our society. Would that not be correct?

Mr. COLLINS. That is correct. I would also point out that there have been studies that looked at the extent to which the compact has offset the higher cost of milk for WIC participants. I would point out one study by the University of Vermont concluded that the WIC participants in Boston were fully compensated for the price increase due to the compact. However, in Hartford, Connecticut they were not. So it depends on where you are and what the effect is on the retail price of milk and to what extent the compact commission provides money back to WIC participants to make them whole. It does not always line up one for one.

Senator FITZGERALD. And in addition to WIC and food stamps, there are other Federal nutritional programs, I think the Child and Adult Care Food Program, the Nutrition Program for the Elderly. My understanding is those programs are not exempted; is that correct?

Mr. COLLINS. That is correct.

Senator FITZGERALD. So we are looking at a transfer from some very needy people to the producers of the milk in those compact states. It is also my understanding that our United States Constitution in the commerce clause forbids compacts, essentially trade barriers, amongst the states unless they are approved by Congress; is that right?

Mr. COLLINS. I believe that is the case. Not being a lawyer, but I think that is the case.

Senator FITZGERALD. And so Congress had to come in and approve this compact because really what we are getting into here is trade barriers amongst the states. I guess my feeling would be leaving aside, let us say, for example, that everything that Senator Leahy and the advocates of the compact say is true and that it does not cost consumers more, but yet somehow the producers do better, and that nobody comes out the loser here, everybody is a winner. Let us stipulate for a moment or assume for a moment that, that is true. I would be concerned about the precedent here because really what we are allowing here is trade barriers between states where we are protecting producers within certain states and when you think of our whole world economy going toward more globalization, more free trade, here in the United States we are actually setting up balkanizing our country and allowing trade barriers between states. And so I would be very concerned about the adverse precedent that the dairy compact sets.

And certainly if it were to come to any other part of our economy, I think you would hear a lot of people up in arms about this. I think of this as a classic case of what Milton Friedman wrote about in his book Capitalism and Freedom, where he talked about how it is easy for someone who is going to benefit from a program or a subsidy to go and lobby Congress to get that subsidy or that protectionist legislation that is going to make them a whole lot of money real quick. And the rest of us, the general public, it only costs us a dollar or a couple of dollars a year so we are not impelled to go to Congress to lobby to fight against this new subsidy program. This seems to me to be a classic case of what Milton Friedman was talking about. Thank you very much.

The CHAIRMAN. Well, thank you very much, Senator. Mr. Collins, let me just preface this question by saying that at the time that USDA came forward with its so-called 1–B policy, the reform policies, last year, I studied that as an individual Senator and I wrote a public letter published in the Congressional Record commending the Secretary and supporting that idea. I did so simply because I appreciated that it undoubtedly was going to be controversial. Members of our committee, however, agreed or disagreed, but not strongly, and as a result, and I just say for the record, we did not have a hearing. We did not take legislative action to countermand what you were doing or to improve upon it.

Essentially we recognized that the farm bill we passed in 1996 advocated that you do just what we had asked you to do. Some of us felt you should have done more and some maybe less, but nevertheless this was clearly consonant with the law that we had passed. Now the House of Representatives did take action specifically in opposition to what you had done, but it did not pass two houses, was not debated by the Senate. And so the point has been made how could this possibly in a democracy come to pass? It happens in a democracy because some decisions are made when appropriations bills are not passed, when there is a large big casino at the end of a situation, where people who are around the table have an opportunity to write law without benefit of this committee or the Senate or what have you. That is the situation we are examining and one reason why those who disagreed with that procedure demanded these hearings today which we are giving.

Now I have no prediction of what the Senate will do this year, even what this committee will do. But I appreciate your laying before us the facts and we may inquire of you for some more as we have this morning, as well as Mr. Salathe, who has been very helpful to us. Even as we have been talking about this, your testimony includes lots of other things and I would commend everyone to read it because it describes monies paid by the Congress or through legislation to dairy farmers, largely because of emergency relief both last year and a signup period that is proceeding now for additional payments this year.

These payments are fairly substantial and we have talked—whether the Cato Institute is right that $400 million is transferred from the public to dairy farmers, it is very clear that at least two or $300 million are going to be transferred in these programs. Now, dairy farmers will say, well, that is only justice because of weather conditions or other problems that we faced and, indeed, they would say what about the corn farmers and the soybean people and the folks in rice and cotton who the Congress at least in total has awarded after all the payments they finally made and you worked out the regulations maybe almost $9 billion last year.

Now, in part the rationale for that came from some other statistic that you furnished. Even though these are in agate type, people were reading carefully last year what net farm income was throughout the 1990s, the last 10-years, the last 5-years, the last year, and your prediction for this year, very relevant. Now without your trying to remember off the top of the head any better than I can, but roughly you have said in your publications that the farm net income for about a 10-year period is somewhere, as I recall, in 45 to $46 billion range, and that was roughly true for 5-years plus or minus a billion either side.

But last year you predicted ominously in 1999 that this was going to dip to maybe 43-billion. Now that was not nine billion underneath the average. It was arguably two or three billion. Congress could have said, all right, we want to make farmers in America whole in the aggregate without picking states or classes or crops so somehow we will provide two or $3 billion more. But instead we provided nine, dairy farmers as a part of that. Our part was really very small, you know, leaving aside the economics or the social justice or movement to consumers. We really got our part of it and maybe not as much as someone said today, the AMTA payment people, who were out there in other fields.

Now this year preliminarily as I read, you come up with something like $40.5 billion prediction for net farm income, at least right now. Now you probably will revise that as the year goes on up or down. I don't know how market prices will go. For the moment, future prices, hog and cattle prices, other things seem to be moving in a pretty good trend. You hate to say that for fear that, that will jeopardize that progress, but it is probably substantial. But can you give us any idea of how often will you revise the forecast? And I make that request because my guess is that before long a debate will ensue in the Congress and people will say, well, we are back to trying to make things fair again and level and Mr. Collins and his associates have said they are going to go here if we do not do something. Do you have any overall comment about this?

Mr. COLLINS. Yes, a few comments. We try to revise these forecasts every month. We publish price and supply and demand forecasts every month for commodities and then we use those to scale up and estimate farm income for agriculture as a whole. I would say that if you look back over last year, those numbers were used quite a bit to justify the size of the emergency package. One of the things that we also do is to sort of take that figure apart and look at crops versus livestock. And that is one of the reasons that I think a lot of people justified the larger package last year because the drop in income to principal crop producers was greater than the drop in farm income to agriculture in its entirety.

As we look out for the 2000–2001 marketing years, we see a similar development. We expect to have stronger livestock revenues, but we will have weaker crop revenues and so for the moment, we are looking at a year over year decline of something in the order of $7 billion or so for principal crops. Likewise, milk revenues will come down because we are going to see a several billion dollar drop in milk revenues, understandably coming off of a record high milk price in 1998–99.

So these are numbers that can be used, I think, to look at a benchmark and make some judgment about the appropriate size of a package. Last year's package when we go back and look at it for the 1999–2000 crop year, the $6 billion component of it which was for major field crops, that brought net cash income for the major field crops, in fact, higher for the 1999 crop than it was for the 1998 crop.

The CHAIRMAN. Yes.

Mr. COLLINS. But it did bring it about where it was for the previous 5-year average, again understanding that, that previous 5-year average had some very high years in it. So in that sense, you could argue that (a) it was too high because you moved up above the previous year's income or (b) it was about right because you were at the previous 5-year average. So we will be happy to provide all of the benchmark data you would want for agriculture as a whole for crops by themselves on a calendar year, or on a marketing year basis, so we we'll give you all kinds of numbers from which you can justify almost anything that you would want to justify for the year 2000. I say that a little bit facetiously, but the numbers will show a fairly sizable drop because markets are extraordinarily weak, particularly for crops. They are coming back for livestock, but for dairy, as we have talked about here at this hearing today, they are also extraordinarily weak for dairy. So I think that can be a guide when you think about what might be done legislatively this year.

The CHAIRMAN. When will the next report come out? Do you have a———

Mr. COLLINS. Well, we publish our numbers every month in Agricultural Outlook magazine.

The CHAIRMAN. Yes. When will the next issue of that?

Mr. COLLINS. It normally comes out about the third week, third week of the month so in another couple of weeks here we will have the February numbers come out.

The CHAIRMAN. But you would at least preliminarily see that the crop situation is in decline, livestock situation going upward, and dairy in decline?

Mr. COLLINS. Well, the numbers for net cash farm income are in my head. For 1999, net cash farm income was about $59 billion. For the year 2000, our forecast is $49.7 billion which is a 20-percent drop and that would be the lowest level since the 1980s. You would have to go back to the 1980s. Of course, that projection does not include any emergency supplemental payment program, but it does include $17 billion of government payments we would expect to make in calendar year 2000 even without an emergency supplemental.

The CHAIRMAN. Often comment is made about the lack of a safety net, but, as you say, there are 17-billion which is a fairly sizable net plus whatever else we may want to talk about at that point.

Mr. COLLINS. At USDA, we say that it is not parsimonious.

The CHAIRMAN. No. Do my colleagues have other questions of the witness? We thank you as always. We look forward to your testimony and opportunities really to gain information from you at each juncture of this debate. Thanks for coming.

Mr. COLLINS. Thank you.

The CHAIRMAN. The Chair would like to call now a distinguished panel that will include Gregg L. Engles, chairman and CEO of Suiza Foods Corporation, Dallas, Texas; Mike Yoder, President, Indiana Professional Dairy Producers from Middlebury, Indiana; John Wilson, Corporate Vice President, Marketing and Economic

Analysis, Kansas City, Missouri; Dennis Vanderstelt, president of the Western States Dairy Producers Trade Association from Kuna, Idaho; Gordon Hoover, a dairy farmer from Gap, Pennsylvania; Dick Gorder, Wisconsin Farm Bureau Federation Board member; and Wayne Bok, a dairy producer from Geddes, South Dakota.

Gentlemen, we appreciate your participation in our hearing. As many of you have listened to portions of the testimony that has preceded your appearance, we will ask each of you to summarize your comments in 5-minutes. I will just say for the record that each of your testimonies will be put in the record in full so you need not ask permission to do that. That will be automatic for a full record what you have to say and then we will have questions of members, a round of 5-minutes and more if more is required. Mr. Engles.

STATEMENT OF GREGG L. ENGLES, CHAIRMAN AND CEO, SUIZA FOODS CORPORATION, DALLAS, TEXAS

Mr. ENGLES. Thank you very much, Mr. Chairman and members of the Committee. I am Gregg Engles. I am chairman and the CEO of Suiza Foods which is the largest fluid dairy processor in the United States. Let me thank you for the opportunity to testify about dairy policy from the perspective of a fluid processor. First, let me make clear that as the number one dairy processor in the United States, Suiza Foods is absolutely committed to the economic viability of our nation's dairy farmers.

Dairy farmers are our partners. They must have a fair and steady stream of income. Without them and a safe and reliable raw milk supply they produce, we simply cannot operate our business. The Dairy Farmers of America, which is the largest dairy cooperative organization in the United States, now owns 34-percent of Suiza's fluid dairy operations. America's dairy farmers, therefore, now have a very significant and common interest in the growth of demand in sales for fluid dairy products and share in the processing of profitability of the dairy processing sector and because of that we have a common interest in strengthening the growth of fluid dairy sales in the dairy industry generally.

But fluid milk consumption is not increasing. It is decreasing and has been steadily decreasing for the past three decades. During that time, per capita consumption of fluid milk has fallen from approximately 250-pounds per year to around 200-pounds per year or a 20-percent decline. Why is fluid milk consumption declining? Certainly fluid milk faces increasing competition from other beverage sectors, particularly the soft drink manufacturers whose gigantic corporate competitors constantly bombard the consumer with marketing, distribution and product innovation investments.

This is clearly one factor driving consolidation in the fluid processing industry.

Suiza Foods and other fluid dairy processors are working very hard to bring product innovation and marketing to life to reverse this trend of declining fluid milk consumption, but as an industry we are constrained by what we believe is an archaic and inequitable milk pricing system that Congress has allowed to continue. As you all know, our existing Federal milk pricing system was developed in the early 1930s in response to market conditions existing during the depression era.

Low milk prices required emergency legislation that created the first Federal milk marketing orders. Although the milk market pricing system has been modified periodically, its fundamental purpose has always been to maintain viable economic condition for dairy farmers which we fundamentally support. Its fundamental mechanism has always been to tax the consumption of fluid milk by forcing milk processors to pay higher prices for milk that manufacturers of other dairy products including cheese and butter. This we do not support.

I would like to introduce into the record a recent editorial by Dick Groves, who is the editor of the Cheese Reporter, a cheese industry publication. Mr. Groves points out that at inception of the Federal program, fluid milk sales greatly outweighed cheese sales and thus the logical place to tax milk usage to support the farm sector. Because of that tax, however, over the last 60-years, fluid milk sales have consistently declined while cheese sales which are subsidized have grown dramatically. Yet the tax is still levied only on fluid milk sales, now by far the smaller part of total milk usage in the United States.

Mr. ENGLES. The historic rationale for fluid milk premiums is out of touch with today's reality. Fluid milk production and processing are no longer local in nature. Technological improvements have resulted in milk with a longer shelf life. Improvements in refrigeration and distribution systems and our national highway system have brought milk freely into all areas of the country. New technologies such as ultrafiltration and reverse osmosis are rapidly blurring regional production differences even further. Milk now regularly travels coast to coast.

Notwithstanding these significant changes in the dairy industry, Congress has been unwilling to move the industry to an unregulated status or materially change the regulatory scheme. Congress seems content to allow the current system to continue to charge fluid milk processors higher premiums than those charged to other dairy processors. As we know from experience in many areas, consumers will avoid paying even hidden taxes reflected in artificially high prices by choosing substitute goods.

The higher price charged to fluid milk processors increases costs to consumers and drives down consumption. The declining consumption will, in turn, reduce dairy farmer income unless, of course, Congress is willing to authorize additional subsidies to support the price. Regional dairy compacts are at their core an amplification and continuation of the traditional approach to dairy support. That is Class I premiums, albeit on a regional basis today.

The Northeast Dairy Compact has only one purpose: to raise the price of raw milk used for bottling above the prevailing Federal price. Mind you this increased price applies only to bottled milk, not milk used in the manufacture of cheese, butter or other dairy products. As of January 2000, raw milk processed for bottling in New England Compact states cost $16.94 per hundredweight, while that used to make cheese cost $10.05. That is a 69-percent premium for identical raw material. This premium raises the price of fluid milk to consumers. Therefore, is it any wonder that consumers view cheese as a better nutritional value for their dollar, driving growth in cheese sales, while fluid milk sales have declined.

If we continue to try to enhance dairy farm income by taxing fluid milk sales alone, we will ultimately drive the category down to the point where we have insufficient volume to support farm incomes. Not surprising, at the same time that fluid milk consumption is declining, New England dairy farmers who are receiving more money for their milk under the compact system have increased production. Milk production in the New England states has grown far faster as a whole than in the United States since the compact began. This increased production together with decreased consumer demand has resulted in excess production. Some of this excess production has been absorbed in neighboring states, driving down the prices at which dairy farmers in those states can sell their products and some has been purchased by the Government as surplus production.

Understandably, all dairy farmers would like to receive the higher premiums paid in the compact states for their products. What rational businessperson would not choose a higher price for his product. If, however, that is a course that you choose and you authorize compacts for other states, dairy farmers in those states will also increase production. It is human nature. It is good business. Then on an even larger regional or national scale, the cost of milk to consumers will increase and consumption will decline. This imbalance of supply and demand is a deadly downward spiral that ultimately must result in you, Congress, getting back in the business we have struggled as a Nation to put behind us. That is being excess production.

To extricate yourself from such a cash subsidy which in the early 1980s exceeded $2 billion per year, you might then take taxpayer money, pay dairy farmers to slaughter cows, which we have done before, which would in turn lower beef prices and bring the cattle ranchers to your door knocking for subsidies to give them relief from excess beef supplies. Surely we have learned from the mistakes of the past and must not let history repeat itself.

Unfortunately, the purported benefit of the Northeast Dairy Company, the protection of the small dairy farmer, has not been realized. During the first year of the compact, dairy farms in the New England states declined at a 25-percent faster rate than during the previous 2-year period. Dairy farms in New England and elsewhere in the country have been exiting the business at a rate of approximately 5-percent per year. That decline is due according to the American Farm Bureau Federation not to milk prices but to the increasing age of farmers, the unwillingness of children to take over the business of dairy farming, and the attractiveness to farmers of market prices for their land.

Our economy has created enormous opportunities and alternatives for dairy farmers and their families. There are many among us who believe that this represents progress and is the intended result of a prosperous capitalist economy rather than a case for continued government intervention.

What the Northeast Dairy Compact has done is benefit a handful of very large farmers who receive by far the lion's share of payments from the compact premium. But this marginal benefit has come at the expense of consumers who have paid $85 million more for milk than they would have paid without the compact and at the expense of the dairy industry as a whole.

In summary, the dairy industry is complex and so are the issues surrounding it, but the solution does not have to be complex. I believe that Congress should not expand the dairy compacts to additional states and should allow the Northeast Dairy Compact to sunset on schedule. We need to move to a transparent and simple pricing system for raw milk in which the users of that product compete in the market place for the product and pay the price that the market will bear.

My vision for the future of the industry is quite clear. I see a vibrant and growing industry. I see technological change and innovation reducing cost to consumers. I see product innovation and marketing new products, attracting more consumers and increasing their consumption of dairy products. And finally I see Suiza Foods 18,000 hardworking and dedicated employees have a reason to fill secure about their futures and excited about their industry and the opportunities to creates for them and their families. We can make this vision a reality, but we need your help in creating a playing field that is not constrained by the heavy hand of government regulations.

Like every other successful industry in our country, we need market forces to drive supply and demand and set prices for the raw materials we use in our business and we need Congress to have the wisdom and courage to take a stand and seek market oriented solutions which address the needs of all constituents in our industry, our dairy farmers, our dairy processors and our consumers. Thank you very much.

[The prepared statement of Mr. Engles can be found in the appendix on page 150.]

The CHAIRMAN. Thank you very much, Mr. Engles. I allowed you to continue beyond the red light for awhile because it is important to complete your thoughts, but to the extent that each of you are able to stay within the 5-minutes or a little bit of leeway, we would appreciate that. Mike, it is good to have you here today, always a fount of common sense from Indiana, which I know you will share with this committee. Mr. Yoder.

STATEMENT OF MIKE YODER, PRESIDENT, INDIANA PROFESSIONAL DAIRY PRODUCERS, MIDDLEBURY, INDIANA

Mr. YODER. Thank you, Mr. Chairman. By way of introduction, I would say that my comments today are, as you asked to be, presenting what we view as the status of the dairy industry, but also my comments represent not just my views but my entire board of directors, and they have okayed my comments today. Nonetheless, I am the only one here today to take the heat.

From our view, dairy farming has been one of the United States agriculture's bright spots, especially the last 2-years, which have been great in terms of prices received and because of low feed prices pretty good profits. We believe that for the most part dairy farmers are operating from very healthy financial positions and are well situated to deal with a short period of low prices. Although some would say that the current prices are disastrous, I guess I would differ with that point of view.

If we examine the current low milk price compared with some actual costs of production, I can demonstrate that the two numbers are very close together for most dairy farmers. For the year 2000 on my farm, we are projecting that our cost of production will be in the neighborhood of $13.45 per hundred pounds of milk produced. This correlates well with data from universities that benchmark these types of cost production. They indicate a range for my dairy farm to be somewhere between 13.20 and 13.60. As near as I can determine, our price for milk that we will receive for January's milk will be approximately 12.50 to 12.75 per hundredweight.

In addition to that mailbox price, we will add on average another dollar per hundredweight through the sale of surplus dairy cattle. So although the gross dollar income that we expect to receive in January will be between 13.50 and 14.50, I have here that while it is not as much fun as the $18 we got last year, it is still a far cry from disaster for our farm and I think for most farms.

The last 2-years, the industry has experienced a significant volatility in prices which is something I think we are not accustomed to managing in the dairy industry. I do believe, however, that dairy farmers can learn to manage a more volatile market with a few provisions. First of all, I think confidence in the futures market that has recently been developed needs to be restored. It is our perception that last year, some of the volatile, the dramatic swings in price were the result of some inaccurate reporting of stocks. And I think that we need to somehow improve that reporting of dairy inventories.

I think expansion of the Dairy Options Pilot Program would be helpful as well. I know that in my particular case, we are going to take advantage of that program this winter. Perhaps some of the volatility has already been taken out or has been taken care of with the new Federal orders structure although I really do not know because nobody has really received a milk check from this new structure yet and so I think it is a little too early maybe to make that judgment.

Also, we are a little concerned about the rumor of changing the nature of the support price to one that is tied to a cost of production. We are very much opposed to anything like that. In Indiana, dairy farmers believe that a support price more closely reflects a very low safety net. Closely related to dairy prices is the issue of dairy imports. Over the last year, we have seen significant amount of imports, an increase in imports, a number of these imports are used for cheese production. And a number of these imports are imported that are not classified in such a way that they are subject to any import quotas. So we are concerned that the United States has become the sponge of choice when there is a need to soak up surplus dairy products produced elsewhere in the world.

During times of excess production in the U.S., we do not believe it makes sense for the United States government to be purchasing surplus dairy products, domestic dairy products, especially cheese, that are manufactured using foreign-produced surplus dairy components. This amounts to using our tax dollars to help solve other countries' dairy surplus problems.

I would close with just a comment on dairy compacts. In the state of Indiana, we took a look at that last year. We had a committee that represented dairy farmers from across the state. We did not like what we saw. We felt that if the dairy compacts were allowed to expand, that the dairy industry in Indiana would be—that would be a detriment to our industry. Our conclusion was we would like to see the dairy compacts die or, at least, at the very least, contained to where they are now in the Northeast. Thank you.

[The prepared statement of Mr. Yoder can be found in the appendix on page 159.]

The CHAIRMAN. Thank you very much for your testimony. Mr. Wilson.

STATEMENT OF JOHN WILSON, CORPORATE VICE PRESIDENT, MARKETING AND ECONOMIC ANALYSIS, DAIRY FARMERS OF AMERICA, KANSAS CITY, MISSOURI

Mr. WILSON. Thank you and good morning, Chairman Lugar and committee members. My name is John Wilson. I am corporate vice president of Marketing and Economic Analysis at Dairy Farmers of America. I am speaking on behalf of the 24,200-dairy farmers who own our cooperative. DFA is a dairy cooperative that is owned strictly by dairy farm families. Our purpose is to market all the milk produced everyday by our members at a fair return. DFA's owners operate dairy farmers in 45-states and will produce about 21-percent of the U.S. milk supplied during the year 2000.

DFA is structured to assure dairy farmers control the organization. To ensure that the cooperative serves its local members, DFA maintains a grass-roots structure made up of seven geographic areas. Each area's marketing strategies and policy development is set up and controlled by an area council made up of dairy farmer members who are elected by the area's farmers. Each area council elects representatives to the corporate board which oversees the policy development and direction of DFA. To ensure even more grass-roots participation, each area council has district leadership, delegate and resolution structures that allow for many voices to contribute to the direction of their cooperative.

On behalf the members of DFA, I want to express my appreciation for the action Congress took to correct the Federal order final rule. As you recall and as has been mentioned earlier today, USDA did attempt to lower dairy farm income by lowering Class I differentials that processors are required to pay dairy farmers. This action was reversed by Congress with the passage of the Consolidated Appropriations Act of 2000. Congress sent a clear message that it was not their intent to lower farm income when it called on USDA to reform Federal orders.

DFA strongly supports Federal orders for three basic reasons. One, Federal orders establish minimum farm prices. They assure consumers of a steady supply of fresh milk and they provide for orderly marketing. An unregulated milk market would be extremely disorderly with investor owned processing plants taking advantage of dairy farmers during times of excess supplies. Federal orders cannot completely solve the problem, but they do play a major role in equalizing the imbalance of bargaining power between producers and purchasers of milk. For these reasons, DFA strongly supports Federal orders.

The economic environment in which today's dairy farmer must operate is a tough one. Price volatility is the name of the game. Within the last 2-years, the Class III price has been as high as $17.34 and as low as $9.63 back in December of 1999. The last time the Class III price was that low was July of 1978 which is over 21-years ago. So obviously dairy farmers are not very happy about current price levels.

Cheese and nonfat dry milk is currently trading at or very near the price support level. Without our dairy price support program, it is likely that cheese and nonfat dry milk would fall significantly to lower levels. Some would say we should let our dairy prices fall to world levels and thus become competitive with the world trade.

Currently the world price for milk used to produce butter and nonfat dry milk is calculated to be $7.03. The comparable price for milk used to produce cheese is $6.68. I cannot imagine the impact on our commercial dairy industry if our prices were allowed to go that low. The safety net provided by our dairy price support program is real. We strongly advocate its indefinite continuation.

DFA and others will be asking Secretary Glickman to modify the make allowance used in the price support calculation to equal the effect of make allowance in the Federal order prices. Today if you calculate the new Federal order Class III price using the commodity prices established under the price support program, the resulting price is $9.74 per hundredweight, not the 9.90 that Congress has mandated. It would be only fair that Secretary Glickman make the appropriate adjustments to the price support make allowance to reflect the intent of Congress which is to floor the price of milk to dairy farmers at $9.90.

The Dairy Export Incentive Program is a very important tool for the dairy industry. Without this benefit, our dairy farmers cannot afford to export their product in the heavily subsidized world trade. If we expect our dairy farmers to be players in the world dairy trade, we must continue to maximize the use of the Dairy Export Incentive Program.

Another issue of concern involving world trade deals with cheese standards of identity. We understand the National Cheese Institute may petition the United States Food and Drug Administration to allow the use of imported milk protein in the manufacture of domestic cheese. Like other dairy commodities, the world case in price is well below our price due to foreign subsidies. As a matter of fact, the world price is so low, there is essentially no case in produced in the United States. The quantity of imported foreign milk protein would directly displace milk produced by the U.S. dairy farmer. This would be a tremendous slap in the face of the farmer if FDA approves the cheese processor's request.

Governmental intervention is important to assure dairy farmers get a fair and equitable price for their product. However, the Government cannot provide dairy farmers with everything they need. They need market security. They want to control their own destinies. They are fearful they will be swallowed up like the poultry farmer who has become a piecemeal worker. They look at their neighbors who used to raise hogs and no longer have the ability to compete with the vertically integrated corporations which control the pork industry today. They see the beef industry controlled by a handful of buyers.

These fears have caused dairy farmers to create our cooperative called Dairy Farmers of America. Our cooperative is the farmers' answer to a quickly consolidating industry that threatens the livelihood of dairy producers and their future as independent business people. As we look around other segments of agriculture, we see significant vertical integration from the processor back toward the farmer. Dairy farmers use DFA to vertically integrate from the farm toward the consumer. This gives them market security and perhaps a bigger share of the consumer's dollar.

We believe the United States needs a secure domestic food supply and the best source for that food is from the independent business people that we call farmers. We are doing what we can to perpetuate the farming tradition that has made this country the best place to live in the world. On behalf of our over 24,200-dairy farmer members of DFA, I thank you for your time.

[The prepared statement of Mr. Wilson can be found in the appendix on page 164.]

The CHAIRMAN. Well, thank you for coming, Mr. Wilson, and for that testimony. Mr. Vanderstelt.

STATEMENT OF DENNIS VANDERSTELT, WESTERN STATES DAIRY PRODUCERS TRADE ASSOCIATION, KUNA, IDAHO

Mr. VANDERSTELT. Mr. Chairman and members of the Committee, thank you for this opportunity to appear before you today to discuss dairy policy with you. My name is Dennis Vanderstelt and I operate a dairy in Kuna, Idaho, 20-miles south of Boise. I appear before you today on behalf of the Western States Dairy Producers Trade Association and the Idaho Dairymen's Association.

Western States is an organization of ten western dairy producer organizations which came together in May of 1996 for the purpose of identifying mutual problems and finding common solutions. Our membership which represents approximately 35-percent of U.S. milk production including all three dairy producer groups in California—Western United Dairymen, Milk Producers Council and California Dairy Campaign—and then dairy producers of New Mexico, Idaho Dairymen's Association, Oregon Dairy Farmers Association, Texas Association of Dairymen, Utah Dairymen's Association, and Washington State Dairy Federation. In addition, we have been working with United Dairymen of Arizona. We actively promote a competitive, market driven and price discovery system for pricing milk.

I also represent the Idaho Dairymen's Association which is at trade organization that represents all 932-dairymen in the state of Idaho. The industry in Idaho has grown in the double digits for the last 5-years and will continue this pace if the atmosphere continues to be positive for the dairy industry. Cheese is the main use of milk in Idaho, accounting for approximately 90-percent of utilization.

We need to ask why do we need to have dairy policy? The nature of our product determines that we should have an orderly marketing system. The shelf life of most dairy products is short because of our product is perishable. We would also be in trouble if there were not the mechanism for uniform testing and pricing of the components of milk. There also is the need for price transparency in our industry. Producers need to be assured that they are getting the same basic price as everyone else and processors need the assurance they are paying the same price as their competitors.

Three things have made our industry successful in the past: the Federal milk marketing orders, the coop system, and the increase of milk production per cow, which has doubled since 1970.

Diary looks at some of the other agricultural commodities and is thankful that we are not vertically integrated, but the main reason that the dairy policy and the Federal order system needs to be maintained is to assure an adequate supply of milk for the consumer. You can go into any supermarket and most convenience stores and get your supply of milk at a reasonable price. The price, by the way, is usually below soft drinks, juices and bottled water, our competition in the marketplace. Market forces are driving the price for milk on the farm. We are truly in a supply and demand market. With only 1-percent overproduction, we see prices that fall dramatically.

At the last meeting of the Western States several policy positions were adopted. First, we are in favor of national programs, not regional programs. Second, we believe that price stabilization such as the support program needs to stay in place. Third, we believe that the market access program such as the Dairy Export Incentive Programs need to remain. Fourth, we are opposed to direct payments to producers.

What policies do we want? We need the Federal order system to continue but would like some corrections in the Class III and IV formulas. This should happen in the next several months. The Federal order system does not create surplus milk, nor discourage privately owned cheese companies from locating in an area. Idaho is proof of this. Order 135 was established in the early 1980s. Major cheese companies 10-years later did a major expansion in Idaho. They could have located in Montana but did not because it does not have a Federal order. However, they did come to Idaho instead.

There should also be a mechanism to stabilize our market. The price support program now at 9.80 should be left in place. The cost of this program is very small to the taxpayers. In fact, the GAO scored it at zero cost when Congress extended the program until 2001. Most of the time it is far below the price of milk, but in times such as these it helps stabilize the market. Without the price support system, the volatility in the marketplace would be even greater.

There are also needs to be a way that the industry can access the world markets at prices lower than our domestic prices. DEIP has helped enhance our markets. We would like it to remain in place. In fact, if the direct government payment of 125-million was added to the DEIP, it would at the present bonus price of $690 per metric ton of cheese just about use up the surplus of cheese in the market. The DEIP program also helps with the marketing of dry milk powder which is used in most areas as a balancing product. We have our work cut out for us.

What policies do we not want? Direct payments to producers that are unfair and ineffectual in helping producers are a waste of money. Put the money where it will enhance our market such as

DEIP program. Under the present distribution, a certain Midwestern state produced 14.5-percent of the milk last year, but received 22-percent of the $220 million Market Loss Assistance Program payments. Is this fair or is this suggesting that the western dairymen are a different class of dairymen?

In Idaho, virtually all of our dairies are family owned and operated. Some are large; some are small. But this is America.

The last issue is trade. Let me ask you is there greater danger to opening our markets than there is to expanding exports? All you have to do is look at some of the other ag products in our country and you will have to say emphatically yes.

Should the dairy industry export more? It has to be viewed as an additional market. However, it is a market that says we can only sell at an amount that is less than our domestic price. We still have reservations about fairness in trade and are unwilling to increase our production just to become exporters. We are not willing to export at a loss. The third world countries would like to develop their own agriculture. The question is how do we compete without lowering our domestic price below the cost of production? It is our belief that if our companies are given a chance to develop foreign markets, our industry can find ways to meet the lower prices demanded but only if the world is truly a market price and not a dump price from subsidized product.

If some of the major countries like China, Russia, India and all of Indonesia decide to import rather than develop their own dairy industry, then U.S. dairy producers need to be ready to fill those markets. Once again, leave the DEIP program and as the opportunities present themselves, we can supply the product.

The other side of this equation is imports. This is important. Do not trade away our domestic dairy industry for some high tech considerations. Do not allow cheap imports to ruin our industry. If in the trade negotiations the imports of dairy are trade for something else, then the domestic industry will have to shrink. The economic benefits derived from the dairy industry will shrink and rural America will suffer again. We have seen this happen in the sheep industry. Do not do it to the dairy. This is not positive for our country. If we can restrict imports to the current levels, then our industry will survive and will grow.

In closing, just let me say that without these dairy policies, I probably would not be here. The dairy industry would be a fraction of what it is now and we would be importing far greater amounts of dairy products. Without government policy, we would have far fewer farmers and far greater imports in all areas of agriculture. Yet U.S. consumers spend less on food as a percentage of their income than any country in the world. This is not an accident, but the result of many years of strong government policies that have maintained a healthy and efficient agriculture that is the envy of the world. Thanks again for letting us share with you.

[The prepared statement of Mr. Vanderstelt can be found in the appendix on page 170.]

The CHAIRMAN. Well, thank you very much for coming, Sir. We appreciate your testimony. Mr. Hoover.

STATEMENT OF GORDON HOOVER, DAIRY PRODUCER, GAP, PENNSYLVANIA

Mr. HOOVER. Thank you, Mr. Chairman. In school, I failed more tests and questions because I failed to listen to the instructions. So I hope to be done before that red light comes on. Good morning. My name is Gordon Hoover. I am from Lancaster County, Pennsylvania. I am a dairy farmer. My family and I milk 120-cows. I serve on the board of directors of Land of Lakes, the second largest dairy cooperative in the country, and I am here today representing National Milk Producers Federation.

First of all, I would like to say that we believe that USDA's final rule has complied with the congressional directive in the farm bill. Moreover, we believe that USDA has established a solid framework for the future of the Federal order system, one that preserves the elements of the existing system that historically has served consumers, processors, and producers, and one that also makes significant changes to reflect the realities of the marketplace in the future. It will take time to assess all the impacts of these changes and we are hopeful that we can allow this system to function without any further tinkering.

Three other dairy policy issues I would like to mention are continuation of the Dairy Price Support Program, proposed changes to the U.S. cheese standards, and continuation of the DEIP program. We believe that the Dairy Price Support Program needs to be in place to act as a safety net for dairy producers, especially in light of the catastrophic farm prices such as were experienced by the pork producers in recent times.

We feel that the current support level of 9.90 per hundredweight will accomplish this while not encouraging any production increases. We urge this committee to endorse the 2-year extension of the Dairy Price Support Program as outlined by Secretary Glickman in the administration's proposed farm plan for this year.

Another threat to our dairy economy at the present time is a proposed change to the U.S. cheese standards that would allow the use of dried milk protein concentrate in the production of cheese. Due to insufficient quotas and tariffs, this could displace billions of pounds of U.S. produced milk with highly subsidized foreign imports causing depressed farm prices.

Lastly, we encourage the continuation of the DEIP program. National Milk certainly supports all efforts to reduce international dairy subsidies since they grossly distort the world market and depress world prices. However, the DEIP program allows the U.S. dairy to compete in a limited way with the much more extensive support subsidy practices of some of our export competitors.

Finally, Mr. Chairman, I would like to make two observations as to how we in the producer community are preparing and looking at the future dairy policies. First of all, a larger percentage of dairy producers than ever before, about 84-percent now, mark their milk through farmer owned cooperatives. I believe by working together within our coops, we can hope to balance the power and the marketplace of multi-national corporate dairy produced processors and retailers. The marketing power of the giant conglomerates of the world needs a counterbalance in the form of strong healthy dairy cooperatives owned by farmers for the benefit of farmers.

Second, National Milk Producers has taken the lead in sponsoring a new initiative, the Dairy Producer Conclave, to refocus the energies of the dairy producers and find areas of agreement within our community. We have arranged five regional grass-root sessions this spring to receive input on issues of importance to the industry such as animal health, environment, economic policy, product standards, trade and food safety. After the regional sessions, our steering committee of national dairy leaders will consider the input we have received and attempt to build a consensus on issues for the future.

With that, I would like to thank you for the opportunity to testify today and I would be glad to answer any questions.

[The prepared statement of Mr. Hoover can be found in the appendix on page 174.]

The CHAIRMAN. Thank you very much, Mr. Hoover. Mr. Gorder.

STATEMENT OF RICHARD GORDER, WISCONSIN FARM BUREAU FEDERATION BOARD MEMBER, MINERAL POINT, WISCONSIN

Mr. GORDER. Thank you, Mr. Chairman, members of the Committee, for the opportunity to appear and to testify before you today. I am Richard Gorder, a dairy farmer from Mineral Point, Wisconsin. I am by today's standards a small dairy farmer and when I say small, I mean by operation size, not necessarily stature, farming 200-acres and milking 50-cows. I am also a board member of the Wisconsin Farm Bureau Federation.

I am like thousands of dairy farmers in Wisconsin who are faced with the decision of modernizing, expanding my dairy operation, or exiting the business in the next few years. I started dairy farming in 1979, rented land and facilities until 1988 when I bought my current farm. In 1979, I was one of over 46,000-dairy farmers in the state of Wisconsin. Today, a little over 20-years later, less than 23,000-farmers remain. Wisconsin continues to lose 3- to 4-dairy farmers a day, up to 1,500-per year. Wisconsin loses more dairy farmers in 1-year than most states have in total.

As I decide on how to update my dairy operation, issues such as land base, facilities, technology, and financing are all issues I must consider. One factor that should not be part of my planning process is how the Federal dairy policy will impact my business. Mr. Chairman, I am not a dairy policy expert and if most are honest, few are. After years of debate, today's dairy policy continues to be plagued by regional bias and politics. In 1996, Congress ordered Secretary Glickman and the USDA to reform and to modernize the depression era Federal milk marketing order system. Farmers across the Midwest finally held out hope that the antiquated milk pricing system would be scrapped and a new marketing order system would take into account today's technologies and transportation advances.

When the USDA reform hearings reached Wisconsin, over 500-dairy farmers attended, more than all of the other hearings combined. This is important, Mr. Chairman, as marketing order reform has become more than just a business issue. It has become an emotional issue across the Midwest. Farmers have become apathetic and cynical as to whether reform would prevail over politics, whether government had the ability to bring equity and fairness to the industry. Last spring, the USDA unveiled its long-awaited order reforms. We in Wisconsin were not overjoyed by the modest reforms but realized that they were a small yet positive move towards a more market oriented pricing structure.

Throughout the previous year, the USDA heard opposition from southern and eastern states to the intended proposal. So the USDA diluted its original modest reform to what eventually became the final rule. In the fall of 1999, farmers and coops across the country voted on the reform package and by an overwhelming vote, accepted the final rule. At that time we were to see implementation of the final rule that would consolidate the number of marketing orders and would bring modest changes to the old Class I differentials that price milk using Eau Claire, Wisconsin as a price basing point. We would also see the sunsetting of the price fixing scheme called the Northeast Dairy Compact. However, in November of this past year, regional politics prevailed.

Members of Congress took it upon themselves to overthrow the USDA's final rule that had been voted on by farmers and their coops and instead imposed their own reform that was little different than the system that Congress had originally ordered to be changed. In doing this, Congress totally disregarded farmers' rights when they mandated the new marketing order rules without allowing farmers their rights to vote on these reforms as stipulated by USDA's own rules.

Mr. Chairman, the question is now where do we go from here? First, I hope that you and the Committee have the resolve to help the dairy industry into the 21st century with an inclusive comprehensive policy that knows no regional barriers; to understand and accept that milk will be produced where it can be most economically produced and where there is the infrastructure that can service, process and deliver the product; and most importantly to create a policy that will allow a dairy farmer to profit because of their ability, not because of where they live.

To achieve these goals, I believe that we need to have a policy that has a single nationwide Class I pricing structure, known as national pooling, and uniform rules that regulate the manufacturing industry or uniform make allowances. Only then will we be able to move beyond the regional price distortions and the temptation of politicians to manipulate the system. If this cannot be accomplished, I think Congress should consider total deregulation, a position that has been endorsed by the membership of the Wisconsin Farm Bureau Federation.

Members of the Committee, please let this hearing be the beginning to meaningful change. Mr. Chairman, in all due respect, I trust that this hearing is genuine and not just held as a gesture to appease the Senators from the Upper Midwest. Mr. Chairman, there are many challenges that need to be addressed that can help all farmers across the country. The need for Congress to continue to work on developing trade dialogue that fosters free, fair and open trade; the need to continue to examine tax reform issues that would include risk management strategies; and a need to address environmental regulatory issues that threaten every farmer today.

Mr. Chairman, Members of the Committee, thank you for the opportunity to come before you today.

[The prepared statement of Mr. Gorder can be found in the appendix on page 182.]

The CHAIRMAN. Thank you very much for your testimony. Mr. Bok.

STATEMENT OF WAYNE BOK, DAIRY PRODUCER, GEDDES, SOUTH DAKOTA

Mr. BOK. I too want to thank you, Chairman Lugar, and other members of this committee for allowing me to participate in this hearing. I am Wayne Bok of Geddes, South Dakota. I own and operate a dairy farm in south central South Dakota as well as serving as president of the Associated Milk Producers, Incorporated [AMPI]. AMPI is a Midwest dairy cooperative representing 6,500-members in seven Midwest states.

Before driving to the airport yesterday morning, I helped milk my cows and while I am gone my sons will milk our 80-herd of Holsteins. Statistics define my Midwest dairy as average. I define our dairy as the sum of all I have worked for the past 34-years. When I began dairying, I milked 20-cows using what is now considered antiquated equipment, but though milk prices fluctuated, there was always a strong support price. And as a Midwest dairy farmer, I was milking in America's dairyland, marketing through our hometown coop.

I would not call my early years of milking the good old days, but it is important for you to know where we have been in this industry before discussing the future. Today I milk 80-cows and that is not enough to support two sons and their families. To add value to my milk, I am marketing through a dairy cooperative which moves dairy products up the market chain.

If the next generation of my family wants to milk for another 30-years, we must invest in our family business. Before we invest in state-of-the-art dairy facilities and technology, we need state-of-the-art dairy policy under which I can operate a multi-million dollar business. You cannot operate a 21st century dairy with depression era dairy policy.

U.S. dairy policy must catch up with the dairy industry. The scope and size of today's dairy farms and cooperatives illustrate my point. We are moving from regionally based dairying to the national and international scene. Today I am competing with dairy farms on both U.S. borders for cheese, for nonfat milk and for butter markets. In coming years, I may be competing with dairy farmers on both sides of the ocean. We face an environment of accumulated change accelerated and caused by economic globalization, market volatility and intense competition. We need to leave regional mind-sets and move to a national approach for dairying, marketing and policy.

The dairy policies passed by Congress last fall merely added another building block to dairy's growing domestic barriers. Efforts to bring rational reform to dairy policies failed as regions of this country that benefit from the status quo continue to block those reforms. Regionally based dairy policies such as Federal milk marketing orders and dairy compacts are destructive.

How can I compete internationally when I am not allowed to compete domestically? In a country where California cheese can end up in a Minnesota cheese sauce plant or Iowa fluid milk in a Florida milk carton, it makes no economic sense to build trade fences for milk such as we have seen through regional dairy compacts. Is this not the very reason that our forefathers wanted a unified national economy?

As congressional leaders, you can tear down these regional walls with nationally oriented dairy policies. When developing a policy ask yourself does this policy hinge on regional bias? And if the answer is yes, then discard that idea.

Allow me to offer three ideas that work together to yield a program that helps every dairy farmer no matter where he milks cows. First we need to maintain the dairy price support system and for that to be successful, we need to protect our domestic milk markets. And we also, I think, need to manage our country's milk supply. We all know policy debates are driven by economic backdrop. With mounting milk surpluses and subsequent low prices, our industry is quickly joining other agricultural commodities facing depressed prices. We need to think outside of that dairy policy box.

Mr. Chairman and other members of the Committee, dairying has gotten to be a big business. Since 1990, the size of the average dairy herd is up about 75-percent. Dairy farms are changing. Dairy cooperatives are changing. Markets are expanding and dairy policy must adjust to this new environment. If individual family farms commit hundreds of thousands, even millions of dollars, to an on-the-farm business, you need to adopt national dairy policies which support these efforts.

It is time to move beyond regional discriminatory dairy policies that divide our nation's farmers and to work toward national policies that work for the Nation as a whole. Thank you.

[The prepared statement of Mr. Bok can be found in the appendix on page 186.]

The CHAIRMAN. Well, thank you very much, Mr. Bok. You mentioned in your testimony a point that others have likewise touched upon, and that is if you are going to proceed in the dairy business for another generation or two, you suggested you would need to make more investments and you already outlined the fact that you have a lot of money in your business now and this has become greater over the last 10-years. For this investment to be rational, I am just curious for many of you, as dairy farmers or as those who represent them, what kind of return on capital do you anticipate from that investment? Has anyone made a calculation as to the desirability of investing in an increased dairy situation as opposed to buying United States government 30-year bonds or high tech stocks or various other ways in which some people are making money? What is your calculation, Mr. Bok?

Mr. BOK. The average return on my investment in my dairy, if I go back and average possibly the last 5-years, I am looking at a 5-percent return.

The CHAIRMAN. Five-percent?

Mr. BOK. Yes. When I compare that to one of my sons who has already left the farm and has purchased a small business, he is very disappointed if he is not yielding 30-percent.

The CHAIRMAN. 30. He was making 30-percent on the dairy business?

Mr. BOK. No, no, no. That is after he left the dairy business———

The CHAIRMAN. I see. Yes.

Mr. BOK.—and went into———

The CHAIRMAN. I see.

Mr. BOK. But our farm is yielding about 5-percent.

The CHAIRMAN. Does anyone else have bookkeeping that would yield any—yes, Mr. Yoder.

Mr. YODER. Last year, we received a little closer to 18-percent return on our capital, but, of course, that was record high years. Some of my research indicates that dairy farmers can sustain higher returns on their investment, but they tend to be the larger dairy operations, 500-cows and above. Especially if you get to the 1,000- or 1,200-cow dairy operations, there are some very fine returns at that level. So the smaller farms, 50-, 60- or 80-cows do suffer from a smaller return on investment.

The CHAIRMAN. Well, how small? I mean can you give any idea of how do the 1,000-head do as opposed to the 30?

Mr. YODER. I do not have those figures right on top of my head.

The CHAIRMAN. Are they out there anywhere? Has someone down research?

Mr. YODER. Well, you know, you indicated before that when you use statistics, they tend to be averages and I think in my testimony I indicated that some of the cost of productions that I found with dairy herds that are under 80-cows tended to be up closer to 15 or $16 per hundredweight. Now I know of farms that are less than that, but on the average, and this was from Cornell University and I think it included about 200 actual farms, their average cost of production was somewhat high.

The CHAIRMAN. Right. So that would mean that their return on capital was low.

Mr. YODER. Low. I do not know what the range would be.

The CHAIRMAN. But I am still trying to get some benchmark. In other words, this is not the only hearing in which this is a relevant question. Again and again, people are talking about modernizing and staying in the business and what have you. Now this implies that there is a gut reaction to what kind of return on capital or it does not matter. In other words, you have a lifestyle to which you become accustomed and regardless of the return you continue doing it because that seems preferable to doing something else, but then the question is whether public policy should support this or not. Now, thus far public policy has supported it.

In other words, this question is not often raised as to whether anybody is making money in this field. Now you have testified that you had a good year and you made 18-percent on capital. Was this because you are a highly leveraged operation? In other words, do you have a lot of borrowed money as opposed to equity? Or is that a factor in this situation?

Mr. YODER. I think it might be a factor. In our situation, we are much more conservative in how we borrow money. Actually Farm Credit Services requires me to be somewhat conservative. I think they prefer it that way. I do not know. Maybe there is other members of the panel here. We tend to measure—I do know that some people would use a benchmark of gross profit on cash revenues and indicate good dairies can achieve 20- to 25-percent. Now I know that there are dairymen on this panel that are really raising their eyebrows about that and doubt that, but it can be done. We have done it on occasion.

The CHAIRMAN. That is their gross margin as opposed to once again return on———

Mr. YODER. Right. And, you know, Senator, that maybe it is just a characteristic of the United States, but I think this is probably the only place in the world where a farmer can lose money 20-years in a row and still be in business.

The CHAIRMAN. I see. Another possibility. Anybody else have a thought about this business, return on capital? Is it a good business to be in? Is it something that—obviously all of you are in it.

Mr. GORDER. I would only interject, Mr. Chairman, that I think that you would find that the numbers vary as many as there are farmers. There are just so many circumstances that get weighed into that. I think very few farmers actually sit down and have an actual calculation as to what their return on investment is. There is just so many more factors that are put in place here. And in my modernization plans, believe it or not I am not really looking at my return on investment as much as realizing that if I do not, I am simply going to have to exit the business and that might be a choice.

The CHAIRMAN. And so that probably, as you say quite honestly, that is determinative as opposed to a calculation of other investments you might make or other returns?

Mr. GORDER. Correct. But I mean I also understand what the interest rates are. So as the interest rates have started to move up, I get considerably more cautious and I think that is the general trend of consumers across the country

The CHAIRMAN. Because you have to earn more than the interest rate.

Mr. GORDER. Correct.

The CHAIRMAN. Or the capital you are going to borrow?

Mr. GORDER. Right.

Mr. VANDERSTELT. Chairman Lugar, in Idaho, rather than put a number on what the return is, I do know that Bank of America right now is offering 85-percent financing on a new large dairy. And that would suggest there is a fair amount of profitability in it.

The CHAIRMAN. Yes, Mr. Engles, do you have———

Mr. ENGLES. Well, I just think as an interesting counterpoint that returns to our company, which is a large dairy processor on invested capital last year was slightly less than ten percent. So the pressure on this industry in terms of margins extends really throughout the chain———

The CHAIRMAN. Very competitive industry.

Mr. ENGLES.—from the farm through the processing side of the business, and partly that is driven by the fact that at least in our segment of the industry, it is contracting, and that is a difficult environment in which to operate. So we are interested in policies that can start allowing the industry, I think, as you have heard many of the people here say, to drive growth because that solves a lot of problems in the business.

The CHAIRMAN. Let me ask in the area of exports and imports which many of you have touched upon, earlier we heard the testimony from Keith Collins, an economist at USDA, that costs of production in New Zealand and Australia were significantly lower on average than they are in the United States, significantly lower, said several dollars per hundredweight.

Now, on the other hand, the EU, the European subsidies, were extremely substantial. So you have it with dairy as well as with other products in agriculture a dumping from time to time and our national policy is to try to blow the whistle on this. The future of this is sort of a mixed bag. As Keith Collins said, on the one hand, you have dumping by the Europeans, but here you have the New Zealanders who have done away with all agricultural subsidies, decided as an ag policy, their national destiny is being very competitive. And one way to be very competitive is to have the Government out of it altogether. People simply reduce costs and they become competitive.

And the policies that some of you are advocating are, on the one hand, watch the imports that are coming, particularly into the cheese situation, because that may undermine us. On the other hand, we are not really quite ready to compete worldwide given the fact that there are others that do a whole lot better. Ultimately, my guess is if we progress in the agricultural round with WTO to progressively lower export and import barriers, why our competitive situation in the world may improve vis-a-vis the Europeans, not necessarily with regard to others, and maybe they are a smaller factor. Maybe as Keith Collins was suggesting, the overall world market is big enough to pick up even all of our production which may not be the most competitive. So that is an interesting idea.

But in any event, this is in play and it is an important part of it. Now you have all suggested the continuation of DEIP, even acceleration of that. I think Collins pointed out, out of 160-billion, 3-billion might be affected in terms of these export subsidies. So it is a fairly small issue, but nevertheless one that probably others are going to take a look at in the world. What are you doing? What kind of direct export subsidies are you involved in? We point to the Europeans as the worst offender.

But let us say we got all that chopped back in the due course of time, how competitive is our industry likely to become? Is it possible without the investment we were just talking about in the first question for it to be more competitive to begin with, to actually lower costs, or are we at a point where the costs that we have are fairly stable, and we just have to accept the fact that even if we are not going to win the gold medal in the world olympics of this situation, why we at least might be competitive with some. Anybody have any idea about the future of that competitive situation?

Mr. HOOVER. Mr. Chairman.

The CHAIRMAN. Yes.

Mr. HOOVER. I think one factor and you kind of alluded to it is, and Mr. Collins alluded to it, in other parts of the country such as New Zealand and Australia, their production practices are different. They use grazing so there is a less input cost there.

The CHAIRMAN. Yeah.

Mr. HOOVER. In the United States, we have the ability to supply as much milk. You increase the price and we will supply you as much milk as you want in a minute's notice, whereas in those countries, in order to capture more of the world's market, they are going to have to start to implement more higher cost production practices than we are already at. So for them to capture much more of the world market than they already have is going to bring them up to a playing field that is more equal with our competitive prices.

The CHAIRMAN. Is there any possibility, leaving aside the export market, and that is what we look to in many crops that we talk about in the Committee, for increasing demand in the United States? I think Keith Collins testified there had been an increase in production of about 1-percent annually for the last 10-years. Certainly there are a lot of advertisements—some of you gentlemen are responsible for these—trying to encourage people to drink more milk. It is healthy for them, but this has not moved the market in a dynamic fashion. It is what might be called otherwise sort of a mature market which the extent of it is fairly well known plus or minus some increases in population in our country. But is there any hope out there in the industry that people will drink more milk, that the demand side of this equation in the United States might change? Yes, Mr. Engles.

Mr. ENGLES. Well, I think, in fact, there is some hope there although clearly the political winds are blowing somewhat in a different direction today based on some of the things that I heard this morning, but I think that what you find is that, first of all, we have growing demand for cheese in the United States. There has been a significantly growing demand for cheese. One of the reasons I think that, that is the case is that Federal policy has, in effect, subsidized the price of milk that goes into the making of cheese and that has allowed the manufacturers of cheese to invest against their business and brands and market their product quite effectively and they have done a very good job of that.

In the fluid milk industry, we have been on the other side of that equation. We are the side of the milk shed that subsidizes because that is where the Class I premium is charged and that is an uphill battle that we have had to face. The fluid milk industry is, however, consolidating pretty quickly and people have talked about that extensively in the political context. But one of the things that is driving that consolidation is the need to invest in the business in a proprietary way that develops brands, innovates in the product, and markets those products to the consumers. And you are seeing the larger fluid milk processors because they have greater collective resource being able to invest in product innovation.

Dean Foods, one of the large fluid milk processors has been very innovative on the packaging side of the business end, and you see small and flavored milk sizes being driven by virtue of packaging innovations. Our company has recently introduced three new milk products that are fortified with nutritional benefits for children, active women and elderly people in the northeastern marketplace and we are spending very heavily to promote those and develop them as brands and we are seeing increased consumption of fluid milk products by virtue of that.

But it takes that sort of investment in innovation and spending in a very crowded consumer marketplace to get people's attention, and if we are not able to do that as an industry, I think you will see continuing declines in the consumption of fluid milk. If we are able to invest back against this category, both collectively as an industry and as proprietary companies, I think we do have the chance to turn it around and get this side of the category growing.

The CHAIRMAN. But you are suggesting you are doing this really by differentiating the product, advertising a specific attribute to your milk.

Mr. ENGLES. Absolutely. You have to differentiate the product and you have to market it to people who perceive a benefit to that differentiated product.

The CHAIRMAN. Because milk as milk is not going to have more than 1-percent, but if you have La Suiza milk or some product you have, conceivably you might do better than the 1-percent growth; is that it?

Mr. ENGLES. Well, that is certainly our hope and we are investing a significant amount of money to try and establish the proposition. I think generic advertising has some benefit when it comes to disabusing the public of the notion that milk is somehow bad for you and I think that Milk PEP and those sorts of things have been very effective in that regard. But in terms of building that emotional bond with consumers, I think generic advertising has a hard time being effective.

The CHAIRMAN. Yes, Mr. Yoder.

Mr. YODER. I would just add to that, that I just recently read a statistic on cheese that if we look at American cheese consumption, we are only at the midpoint of what Europeans consume. So if the American appetite for cheese would be somewhat similar to European, I think there is reason to be optimistic in that area as well as continued cheese growth.

You also asked a question about our competitiveness and I think there was a good point made that maybe we assume that New Zealand will continue to produce at that level and perhaps their cost of production will increase especially if countries like the United States would insist upon the same quality that goes into their production as far as sanitation techniques that we are required to produce milk under here in the United States. I am not convinced that milk produced in other countries is produced under the same sanitation requirements that I am required to.

Also, as far as environmental regulations, which have been asked or talked about, I would suggest that I have invested substantially more to protect the environment from manure spills or just from a nutrient management standpoint than perhaps my counterparts in New Zealand. So those are issues that affect competitiveness of American dairy product. If we do not have any more unreasonable regulations, I guess, I think perhaps we can—I am optimistic that we can be competitive in time.

The CHAIRMAN. Now Mr. Engles touched upon consolidation in a part of his remarks, but let me just carry this in a little different direction. As many of you have commented, this is an area our committee has been looking at. We had a hearing on concentration just last week and we are not unique because people are organizing in the pork industry and this has brought attention. We found this happened to a greater extent in cattle and some of you have suggested even further in poultry.

But I think Mr. Hoover and Mr. Wilson both commented how coops have been an effective bargaining situation for producers and that has been suggested. We heard testimony last week, in the pork industry to an extent which clearly has not occurred there thus far. To what extent is there a reasonably level playing field in terms of small producers and people who are buying from you? How would you describe the market at this point? Is more extensive coop organization required? Are the coops the right size and location to do the job? Or does anyone have a comment about the bargaining power in America? Mr. Wilson.

Mr. WILSON. I would try that one. We are a large cooperative. However, we are still a voluntary organization and so just because we today have a large group of dairy farmers together does not mean that we necessarily are able to just establish the price. And we sell a lot of milk to Suiza in partnership with Mr. Engles here, but we still bargin with them with an arm's length. We still bargain every month on the price of milk. We do not tell him what it is going to be. It is a two-way street. We do have more bargaining ability than dairy farmers individually certainly, but there is still an option of dairy farmers going out, jumping outside their cooperative, because really when we bargained for higher prices on Class I, we are really differentiating between different uses of milk, and saying, yes, we believe Class I milk is more valuable than Class III milk. Well, you cannot get that spread very wide because you have different utilizations of different milk purchasers in the market. The higher utilization guy, the more you spread that price, the more advantage he will have competitively.

And so the cooperative, even though we may be large, there are still limits on how much price differentiation we can do, and consequently a limit on equalization of that bargaining power. We still are dealing with the fundamentals of the market that milk is produced everyday and the demand and the supply rarely match up. The balancing piece of that market, that milk market, is I think unlike any other agricultural commodity because it is perishable, it is bulky to move, and the fact that the supply and demand do not match up very well.

The CHAIRMAN. Well, it is interesting, though, you and Mr. Engles, not the two of you, negotiating this month by month, but your associates do this sort of thing. And you represent 24,000-farms, as I understand, which if 111,000 is what we were dealing with in Keith Collins statistics, that is almost one out of four. It is a pretty big cooperative.

Mr. ENGLES. It is a big cooperative, and I think just to somewhat amplify on what John said, but also to give you a somewhat different point of view, the whole notion of, first of all, concentration between on the buy side and on the sell side is one that needs to be understood here, and the second thing what is the nature of negotiation with respect to price in the dairy business today?

First of all, DFA is a much larger organization than we are and we are the largest fluid processor. We represent somewhere on the order of 20-percent of all fluid milk in the U.S., but fluid milk is somewhere around 30-percent of total milk utilization in the U.S. DFA, on the other hand, represents 25-percent of all milk produced, whether it goes to fluid uses, cheese, or whatever. So they are an enormous organization that represents, I think, the supply side extremely well in terms of price negotiation.

The other thing that is really important in this context is to understand that, by and large, we do not negotiate the price in this industry today. The Federal Government, USDA, tells us what the price is, minimum price for classes of milk, and to the extent there is any negotiation with respect to the price is how much more than the minimum am I or other users of fluid milk going to pay? So the fear of the users of milk taking advantage of producers of milk in terms of long supply is, I would say, virtually eliminated by virtue of the Federal regulatory scheme.

On the other hand, when milk is short, you can be certain that premiums go up substantially as to do class prices. So it is a very interesting dynamic today in milk pricing. Negotiation with respect to price is very limited and you have powerful players on both sides of the equation. So I think concern about balance in this area is unwarranted.

The CHAIRMAN. Let me ask a question of the panel. We were discussing in this committee, in fact, we will have a markup sometime in the next month on risk management. Some of you have touched upon this. Mr. Yoder, you mentioned the forward contracting, the pilot options program. This has not really been available in the industry. It is something that I have been a strong advocate of and supported by many members of the Committee who believe that these instruments ought to be available to dairy farmers. Many since the pilots have come into play have not availed themselves of it because it is complex, for the same reason corn farmers, bean farmers find it difficult to figure out how to handle puts options or the forward contracting process.

But nevertheless, many farm managers who do this are doing better than those who do not. Sort of hope for the Lord will provide as opposed to becoming more sophisticated marketers. What has been your experience, Mr. Yoder? Are you just getting into this business of forward contracting or how does it help you as a dairy farmer?

Mr. YODER. Well, actually I am a little red-faced because as a good dairy manager, I should have contracted last year but did not. My experience in talking with other dairymen, there is a lot of skepticism in using the futures market. As I indicated, last year's violent price swings, that were to some degree due to some inaccurate reporting of stocks, I think sort of built, I mean increased that skepticism. My particular coop, which is foremost, does offer a forward contracting which is a little more straightforward and a little easier to understand. I guess I should have checked with them to just see how many dairymen did take advantage of that last year.

My suspicion is, is that with time that will be utilized more than just using a hedge or purchasing an option. We are going to use the option, the Dairy Options Pilot Program, this year mainly because I would just like to learn a little more about what the connection is between the futures price and my mailbox price. And that has been the primary reason that I have not utilized those. We have utilized the futures market and options hedging for grain sales in the past but just have not taken those skills and transferred it to the dairy.

Mr. GORDER. Mr. Chairman.

The CHAIRMAN. Yes.

Mr. GORDER. I, in fact, have used the—even on my small-scale farm—have used the futures. I am not allowed to forward contract because of the discrepancies that regulate between a proprietary plant and a cooperative. Cooperative can forward contract. As we are proprietaries, we are not allowed to. I think that is supposed to at least change a little bit or at least under some trials, but I have gone into the marketplace, or into CME, and purchased contracts for this last fall. And I did quite well. I will be honest with you. When I purchased my put contracts in end of June when the prices started to escalating and I really could not see a good rhyme or reason for the reason that the prices were going to the degree they were, I thought, you know, this is the time when you lock in some prices.

One of the big problems is that, you know, you have to simply look at it as an insurance policy and the idea is that you really do not want to collect on insurance policy. You know it is nice to get your premiums back, but you cannot look at in that respect. Believe me when the prices were where they were in July, I would have liked to had my $2,000 back, but as I let them mature in October and November, I did pretty well. I not only got my money back, but I think you need to continue. I think that your dairy option program is so spotty that it really does not do much of any good, and I need to do one other aspect of this and I need to bring this in. And that brings it back to the Northeast Dairy Compact.

Ask the people in the Northeast have many of those went out and bought put contracts. When someone is guaranteed a floor, what incentive is there for them to go out and use risk management strategies? None. Thank you.

The CHAIRMAN. Well, there would probably be less. Yes, Mr. Engles.

Mr. ENGLES. Well, markets work when they are large and they are trusted and they are liquid. And the market in dairy futures is not that today. And I frankly have a hard time seeing how it is going to get there until you permit Class I buyers of milk to participate in the forward contracting arena. It is 30-percent of the market. It is that most immediate part of the market, and today from the most recent legislation, lower class utilizers of milk are allowed to forward contract, but Class I users are not. So if you are getting a blended milk check that has Class I utilization in it, and you can only forward contract on the basis of lower classes of milk, which obviously pull that average down, you will find it almost impossible for that forward contract to meet your expectations in terms of price. So for these markets to be fully developed and used, they have to be open.

The CHAIRMAN. Yeah.

Mr. ENGLES. And I think that we can say as a fluid processor, we would be active participants in those markets if we were able to do so because certainty is important to us and our customers and volatility is a very damaging thing for our business as well.

The CHAIRMAN. Well, and a lot of discussion has gone on today about the volatility of price, and we all know tracing December, January, February prices, then through July and so forth, if we have this hearing in January and February, it is always a pretty dismal time. You know better to have a dairy hearing in the summer when the situation has changed. My own view, and I always hesitate to get into anecdotal personal circumstance in these things, but, you know, our USDA economist, Keith Collins, has testified, for instance, that the corn price for the coming year, given the overhang of supply and general conditions thus far, might very well be somewhere in the range of $1.90 to 2.10 a bushel. This is for all prices the whole season, which is not very high.

The LDP is about $1.96 and so that sort of sets the floor for the corn farmer, but sort of balancing off of that. Now the week before last, in checking with my elevator there, Beech Grove, just outside of Indianapolis, I found even given the basis situation and so forth that I could get $2.45 for corn. So I sold some. Now for those who are not in the farming game, they said you do not even have that corn planted yet, quite apart from harvested. How do you know that you are even going to have something to sell? And that is always the problem of forward pricing, but if you have a crop insurance policy to cover 65-percent of your crop or 75 or whatever else we are reaching for now in that situation, why you know that you have got something to sell. So there is sort of a twin situation.

And 2.45 is different from $1.96 or 2.10 or whatever is going to happen. Now, why does not everybody in America go out and sell corn at 2.45? In some cases, the basis is different in other parts of the country, but my point is that, just as Mr. Gorder is pointing out, you notice there are fluctuations. It is a volatile market, sort of things change. Now to the extent that we can get a more active forward contracting market, and your point is well taken with regard to the larger players and more of the situation involved in it, we have more possibilities.

But we also have also possibility for people to fail more, too. You know what if you are not a sophisticated person up to date on the futures markets, puts options, or you just think this is “Las Vegas West,” or something of this sort, you have got a problem. And the whole dilemma of this committee trying to help agricultural America through our extensions or through professional groups, through coops, anybody, sort of get into the ball game is imperative even as we try to keep these floors, safety nets, various other situations, that are important. Yes, Mr. Wilson.

Mr. WILSON. I would just like to add a little bit. We support at DFA the concept of forward contracting. We have a program within our cooperative. Roughly 3-percent of our membership participates, which is not a big participation rate, but that is getting more interest as time goes along. But I think we need to be very careful that we do not rely on forward contracting and futures markets as the savior of the dairy industry from the producer side, that hogs and cattle and grains have had futures markets for a long time, and they are probably worse off today than the dairy farmer on average. And so while it is a tool, I think we need to be very careful not to rely on that tool solely and that we still need Federal orders and price supports and all these other issues more importantly than we do a futures market.

The CHAIRMAN. Yes, Mr. Vanderstelt.

Mr. VANDERSTELT. And if I might add to that, Senator Lugar, you know, my banker knows I am a good dairyman, but he does not know if I am a good gambler. And we did the milk futures through the fall, summer-fall, and we do a lot of grain futures, and we do what you are suggesting, but when you are a larger financed operation, you do get asked that question. OK, that banker—he knows the numbers, too, and he looks at them. And he expects certain performance. He would—like I say, he knows I am a good dairyman and when we did the milk futures this summer, it is really difficult because what if they do not work out and how I am going to explain this? And so there is that mental thing to it.

And I do not know how far we are going to see dairymen pursue the futures. There are a lot of them playing with it, lot of them did quite well actually this last summer and late fall, actually November–December. Several of my neighbors were pretty happy through Christmas actually. But there is that drawback that can this get me in trouble? But I do like having them available.

The CHAIRMAN. Well, I think your point is well taken. I would not want to get anybody into difficulty. And I was just saying that probably my banker would be happier than I made the sale at 2.45 than I was waiting for the LDP to clear it away at $1.96 later in the season. I would think that was a healthy move to sort of wicket it in. Now the other side of this is the crop insurance, you know, so the banker knows that I have got something to sell, that I am not out there selling something that is not going to be produced. Then he really would be worried.

I think this whole area in dairy in terms of risk management is something that the Committee and the Congress needs to work with the industry more on so that there are the same elements that are available maybe for some other points of agriculture. And there may be more available than I know about and this is why I am trying to elicit some advice or comment from each of you as experts today because I suspect we are going to have dairy programs of one form or another. All these may go up and down. Congresses come and go and sort of public sentiment. But to the extent that farmers are better prepared really, whatever these markets are, to meet the volatility that we are talking about, why then probably we are better off.

Well, I appreciate very much your patience. This has been a hearing now going on close to 4-hours and you have lasted through all of it and we are grateful to you for your testimony. As you have other ideas, why please furnish them to the Committee. We will keep the record open for a moment or more than that, for a day or two, so that Senators who were not able to attend who may have questions of any of you might be able to submit those and if you can respond to that. Thank you again for coming and the hearing is adjourned.

[Whereupon, at 12:40 p.m., the Committee was adjourned.]

A P P E N D I X

FEBRUARY 8, 2000

Opening statement of Hon. Richard G. Lugar
Chairman, Committee on Agricultural, Nutrition, and Forestry

February 8, 2000

This morning, the Committee will begin the first of two hearings to review federal dairy policy and examine the current structure and status of the dairy industry iii the United States. When the Congress adjourned last year, dairy policy issues were front and center in the debate of the Consolidated Appropriations Act for Fiscal Year 2000. Then, as in past dairy debates, the Congress was divided along regional, not party lines. The outcome of last year's debate was the adoption of the so-called "Option I A" price structure for Class I or fluid milk-, the continuation of the dairy price support program and the extension of the Northeast Interstate Dairy Compact. This new policy has left the Congress, and the country, divided along regional lines.

Regionalism and infighting in the dairy industry do not serve the best interest of consumers, farmers or processors. The purpose of this hearing is to better understand the current structure of the dairy industry and to determine if the present policy fits the current structure and societal needs.

There have been many attempts in the past to find the right match. In the 1970's, the direct cost of the price support program averaged $325 million. By the 1980's, price supports resulted in expenditures of $1 billion per year. In 1983, the Commodity Credit Corporation spent a record $2.6 billion to purchase almost 17 billion pounds of milk products -more than 12 percent of the total domestic milk production. In an effort to bring supply back in line with demand, the Dairy Termination Program was established in 1985 and paid dairy farmers not to produce. The 1990 farm bill set a fixed level of support for dairy products and USDA began to reduce stocks of surplus supplies. The 1996 farm bill established a declining price support level that further reduced stocks to less than one-half of one percent of total production.

Federal milk marketing orders established, among other things, a system of prices necessary to draw milk from surplus regions to deficit regions to ensure consumers of adequate supplies of milk. In 1985, Class I differentials, or the amount added to a base price when milk is used for fluid consumption, were set by law. Recognizing technological advances in transportation and handling, the 1996 farm bill gave USDA the authority to modernize and streamline the milk marketing order system. The USDA recommended a system that took into account the changing structure of the dairy industry; however, that recommendation was overturned by my colleagues in the Congress.

Today, we will examine several key issues and hear the answers to some crucial questions. What impact has federal dairy policy had on consumer prices, producer income and federal outlays? What is the current structure of the dairy industry? Does the policy meet the needs of consumers, farmers and manufacturers'?

I am hopeful that those who will testify today and tomorrow will share some wisdom on these issues.

In the first group to present testimony, we are pleased to have a host of elected and appointed officials before the Committee this morning. We welcome you and look forward to your statements.

TESTIMONY

"THE FEDERAL DAIRY PROGRAM AND ITS IMPACT ON WISCONSIN"

BEFORE

THE UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

BY

THE HONORABLE TOMMY G. THOMPSON
GOVERNOR
STATE OF WISCONSIN

TUESDAY, FEBRUARY 8, 2000

Introduction
Good morning, Chairman Lugar and Members of the Committee.

Mr. Chairman, I would like to thank you for holding these hearings. I appreciate your interest in agriculture and your desire for the Agriculture Committee to reclaim issues associated with dairy – issues that affect Wisconsin more so than any other state in America.

Wisconsin is the nation's top producer of cheese. In fact, if Wisconsin were a nation, it would be the second-leading cheese producer in the world. And my state has more dairy farms than the states of California, New York and Pennsylvania combined.

Wisconsin is America's Dairyland. However, the number of family farms in my state is dwindling rapidly. And with their loss, we are witnessing the demise of the very people who helped build this great country – our proud farm families.

In 1990, 34,000 family dairy farms existed in Wisconsin. Today, that number has plummeted to 21,000, representing a loss of three dairy farms each day for an entire decade. In fact, during the past two years alone, Wisconsin lost more dairy farms than most other states have ever had.

What is more distressing is the dramatic increase in the number of farms that have gone out of business since the Northeast Dairy Compact was enacted. Between 1997 and 1998, more than 2,000 family farms [1-99 head] folded, an increase of roughly 100 percent over the previous average yearly loss.

Ladies and gentlemen, to say Wisconsin's dairy farms are in trouble in is an understatement – they are in dire straits. And I am at a loss to understand why Congress continues to stand with a heavy foot on the throat of the Wisconsin dairy farmer.

History of Reform Efforts
As all of you know, Wisconsin dairy farmers have been discriminated against under the Federal Milk Marketing Order System, commonly known as the Eau Claire rule, for generations.

Congress has attempted to update this pricing regime for years. Farm bills in 1980, 1985, and 1990 all called for reform, but failed. When Republicans took control of Congress in 1995, I believed that the free-market would finally be allowed to dictate the price of milk in America.

When discussions began to take place on the last Farm Bill, we thought our dairy farmers might finally get equal treatment. One of the stated intentions of the 1996 Farm Bill was to create a Federal dairy policy that was more modern and market-oriented – a system that would reflect innovations in the milk industry and position the United States to become a major trader in world markets.

In the House, legislation was moved to replace the Eau Claire system with a more free-market system. Finally, I believed, Congress would do something to help save our family farms.

But when the final version of the 1996 Farm Bill emerged, there were no market-based reforms. Instead, the Farm Bill let the USDA decide what types of changes were necessary to reform the 1937 system and consolidate the 31 milk marketing regions nationwide. It also granted temporary consent to the Northeast compact, while the USDA considered action.

In January 1998, after countless studies and hearings in various regions of the country, including one in Green Bay, Wisconsin, where I testified, the USDA released two options to proceed. Agriculture Secretary Dan Glickman proposed two potential approaches to reforming the milk pricing system: Option 1-A, commonly recognized as the status quo, and Option 1-B, a modest, more market-oriented reform. After more than a year studying the two options, the USDA issued a modified reform plan that was extremely modest in April 1999.

While I was not pleased with the scale of the reforms, I was pleased that some reform would be implemented, and the Northeast Dairy Compact would be eliminated when the new Fiscal Year began, October 1, 1999.

I was confident the reforms the USDA created would be implemented because there was no reason to believe otherwise. For the Senate held no debates on the Federal Milk Marketing Order System or Dairy Compacts in any committee, nor on the Senate floor.

However, as the Congress was wrapping up the final appropriation conference bill, dairy became the issue. At the last minute, a bill was added to the final package to throw out the reform plan the USDA spent two years developing. But that was not the only dairy provision added. The spending package also included language to extend the Northeast Dairy compact until Sept. 30, 2001.

Wisconsin farmers, along with many of their Midwestern peers, were again left on the political auction block.

Compacts

Ladies and gentlemen, compacts are the wrong direction for our national dairy policy. The Northeastern Dairy Compact has resulted in a windfall for Northeastern dairy farmers – at the expense of family dairy farms across the country.

Compacts set the minimum prices for fluid milk higher than those established under Federal Milk Marketing Orders, even though Northeast dairy farmers are provided with minimum prices higher than those received by most dairy farmers throughout the nation.

Compacts were supposedly designed to save family dairy farms. Instead, the opposite has proven to be true. Together, compacts and the Federal Milk Marketing Orders have resulted in a devastating effect on Midwestern dairy farmers, driving milk prices to record lows and family dairy farm closings to new highs.

I would also like to gently remind committee members of this country's strong history and advocacy of free trade. Regional pricing compacts run counter to the intent and spirit of our Constitution. The Constitution's Commerce Clause, Article 1, Section 10, was written by our founding fathers to prevent states from erecting trade barriers.

Our founding fathers knew that the Commerce Clause was vital because the lack of such a clause in the Articles of Confederation had led to damaging trade barriers between the states and national disunity.

We have the opportunity and ability to practice what we preach yet the federal government and some members of Congress continue to cling to an antiquated system, which penalizes farmers simply for where they live.

Wisconsin and Midwestern farmers work just as hard as their counterparts in other states, yet the price of their product is intentionally and artificially forced below that of their peers. That is unfair and unjust.

Compacts erect trade barriers to the free flow of milk across state borders, amounting to nothing more than tariffs.

We've worked hard to reduce or eliminate tariffs imposed by Europe, Japan, or other countries in an attempt to keep out U.S. products. Congress has consistently recognized that tariffs are discriminatory and hurt American agriculture and industry. Yet, some Members of Congress propose to put a tariff-like system between regions of the country.

Mr. Chairman, instead of pitting the America dairy farmer against one another, it is time we brought them together and let the free market dictate the price of milk in America.

We made a commitment in the 1996 Farm Bill to decrease government intervention in our agricultural markets. Dairy pricing compacts fly in the face of this commitment to market-based pricing reform. I am amazed at some of the so-called "free market" advocates in Congress who are supporting these pricing cartels. And, I ask you to consider whether compacts are GATT-legal.

Regional pricing compacts are unfair to small family dairy farmers.
Pricing compacts guarantee higher fluid milk prices to dairy producers in the compact regions. Basic economics, born out by the experience in the Northeast Compact states, tells us that higher milk prices result in two things; increased milk production at the farm and decreased milk sales at the supermarket. The net result? Too much milk is produced.

This excess fluid milk is sold to manufacturers of cheese, butter and nonfat dry milk, thus driving down the price for milk used for manufacturing. So, while fluid milk prices are up in the compact regions, manufacturing milk prices are down in all regions.

On face value alone, it is unfair that producers in compact regions receive higher milk prices at the expense of producers in non-compact regions.

Consider an analysis by the University of Missouri that shows that if a Northeast and Southern Compact were to exist, producers outside of the compact states stand to lose between $0.17 and $0.21 per hundredweight of milk. This is unconscionable.

Benefiting some dairy producers to the detriment of other producers only serves to build destructive forces within our national dairy industry.

Our family farmers are not the only victims of compacts. A recent study by economists at the University of Massachusetts indicates retail milk prices paid by consumers in Boston were shown to increase 20 cents per gallon when the Northeast Dairy Compact was put into place.

Regional dairy pricing compacts distort market signals and are disruptive to national markets.

Mr. Chairman, some individuals argue that a compact in one area of the country has no effect in another part of country. This is either economic ignorance or intentional misrepresentation.

Try as we might, we cannot evade the power of the marketplace. A compact in one region will lead to lower prices in another region because we are lessening, not increasing consumer demand due to higher prices. When supply outstrips demand, something has to give.

In the case of compacts, the federal government is asking consumers in the compact regions and dairy producers in the non-compact regions of the country to do the giving.

Vermont's production increased four percent in 1998 and production in the other five compact states was up 2.5 percent, while Wisconsin production increased by only one-half of one percent.

In fact, a University of Wisconsin study estimates the real cost of dairy compacts exceed $145 million in lost farm revenues per year in non-compact regions.

Even those states with compacts are witnessing a decline in small family farms, as Vermont is losing farms with herds with less than 100 cows. So, while the United States is charging into the longest period of economic growth in history, our dairy farm families are watching it roll by and over them.

Compacts will hurt, not help the manufacturing states of the Midwest, Southwest and West.
Wisconsin, its been said, is opposed to compacts because compacts are not a viable option for dairy manufacturing states in the Midwest, Southwest and West.

While it is true that Upper Midwest producers would not benefit from a compact since higher fluid prices would be more than offset by lower manufacturing prices, it is not the lack of benefit to us but the very real imposition of costs on us that is objectionable.

The Northeast Compact was never intended to be permanent.
Finally, I would like to remind Congress that the Northeast Interstate Dairy Compact was never intended to be a permanent fixture.

The Northeast Dairy Compact was intended as an interim measure, designed to sunset with the implementation of the implementation of USDA's new Federal Milk Market Order system.

Conclusion
Simply stated, we are doing our national dairy industry a real disservice if we continue to price milk based on the location of the cow and proceed down the path of regional pricing compacts.

What the Wisconsin and the American dairy farmer will benefit most from is bold and dramatic reform that eliminates Eau Claire as the standard for setting milk prices paid to farmers and forgets about pricing milk regionally.

Mr. Chairman, I urge you and this Committee to rid the entire country of dairy compacts and do not create more.

Let's allow the free market to work. We are not asking Congress for a unfair advantage, but rather a policy that provides <u>all</u> dairy producers a fair, market-driven price for milk, a policy that allows <u>all</u> of our country's dairy producers to succeed on the basis of hard work, ability to adjust to the market and American farming ingenuity.

Let's do the right thing and put in place a pricing system that treats every farmer in America fairly.

Thank you.

STATEMENT OF SENATOR ARLEN SPECTER

SENATE AGRICULTURE COMMITTEE

FEDERAL DAIRY POLICY

FEBRUARY 8, 2000

Chairman Lugar, Senator Harkin -- Thank you for scheduling this hearing to discuss federal dairy programs and the need for reform. I understand that you will be hearing from a wide variety of experts on this subject over the next two days. Tomorrow you will hear from one of my constituents, James Vanblarcom, a Pennsylvania dairy farmer from Bradford County, Pennsylvania who will discuss how Dairy Compacts would assist dairy farmers in Pennsylvania.

Dairy policy is an issue of great importance to America and of special importance to Pennsylvania. Agriculture is the largest industry in Pennsylvania and dairy is the single largest component of this industry. Pennsylvania is the fourth largest dairy producer and there are approximately 9,900 dairy farms which produce $1.73 billion worth of milk each year. Over the past decade, however, Pennsylvania has lost an average of 300-500 farmers per year. Between 1993-1998, Pennsylvania lost 11.4% of its dairy farmers.

As we all know, the Basic Formula Price dropped to $9.63 at the end of 1999, the lowest price in 21 years (since August of 1978). This is a drop of $7.71 since the end of 1998. Over the past several years, the prices have fluctuated greatly setting new record highs and lows, thereby making any long-term planning impossible for farmers. Price swings of 30 to 40 percent from one month to the next have almost become common in the past few years.

While facing record low prices, Pennsylvania farmers were forced to face record droughts last year. Costs are up in Pennsylvania, because farmers are now buying the feed they already tried to grow. One of the factors that keeps Pennsylvania producers competitive traditionally is their ability to grow their own feed. With extremely low commodity prices nationwide and drought conditions in Pennsylvania, dairy farmers have lost that competitive aspect of producing milk in the State.

We must work together to provide additional drought assistance to the hard hit dairy farmers who are struggling to economically survive each month. The Mid-Atlantic States suffered $2.5 billion in losses as a result of the drought in 1999. Pennsylvania alone suffered $700 million in drought losses. While the FY2000 Agriculture Appropriations bill provided $8.7 billion in disaster assistance for farmers, the vast majority of this money went to farmers in the Midwest to compensate for low commodity prices. Only $1.2 billion of the total $8.7 billion package was provided for natural disasters which had to compensate for all natural disasters nationwide, including Hurricane Floyd, flooding in the Midwest, livestock loss and fishery loss.

We must also work to ensure that we provide maximum funding for the Dairy Export Incentive Program. This program, which facilitates the development of an international market for United States dairy products, is authorized at $66 million for FY2001. We must work to expand foreign markets if our dairy farmers are to be give a fair chance to succeed.

Pennsylvania has a state milk pricing agency that establishes minimum producer, wholesale and retail prices. While the Pennsylvania Milk Marketing Board has been able to provide an over-order premium at various levels on Class I milk to help address producer price needs, the benefit to many of Pennsylvania's producers has been very limited by interstate commerce law and the lack of market-wide distribution of the premium to producers. A regional approach to milk pricing is a better method of helping to stabilize producer prices and address producer price needs affected by local marketing conditions. If properly administered, we now know Dairy Compact pricing can bring benefits to producers at little, if any, cost to consumers, and with no impact on national marketing conditions. I believe future national dairy policy should allow for the expansion of Dairy Compacts.

Dairy Compacts create stability in the dairy markets. In Dairy Compacts, States are able to enter into a voluntary agreement to create a minimum price for milk in the Compact region that takes into account the regional differences in the costs of production. Everyone benefits from Dairy Compacts. Stable prices provided by the Compact help dairy farmers recover their production costs, keep their dairy farms economically viable, and maintain environmental efficiency. Income produced by dairy farms has an economic multiplier effect in rural communities that provide business for feed, seed, fertilizer and equipment dealers, truckers, veterinarians, retail stores, insurance companies and banks. More stable milk prices would be provided to consumers under the Compact. A recent government study showed consumer prices for milk increasing over 30% in the past decade, while producer prices only increased 10%. By stabilizing milk prices to dairy producers and increasing the economic viability of their farms, more land near urbanizing areas will be kept in agriculture to maintain a healthy environment in rural communities.

There are no costs to the government as a result of the Compact. The Compact legislation requires dairy producers receiving the Compact price to pay for any increased costs to government programs that result from Compact pricing regulations being in effect. Milk prices will not increase to Pennsylvania consumers. Retail milk prices in the existing Compact region averaged 5 cents per gallon lower than prices nationally in the first six months of the Compact price being established.

There are other important aspects of the Compact that positively affect consumers. First, the Commission establishing prices under the Compact has representation from the producer and the consumer. Second, the Commission is responsible for continually evaluating milk marketing conditions within the region when establishing prices above the federal minimums. Third, consumer impact and regional milk supply are important considerations of the Commission when establishing the safety-net price for each six month period. This is because Compact provisions require assessments to be made on producer prices within the Compact region if milk production increases within the region to levels that exceed the national average. Although the Compact price is not totally determined by the marketplace, it is certainly impacted by regional marketing conditions. And finally, school lunch and WIC programs will be unaffected due to Compact provisions that these programs be reimbursed for any increase in prices resulting from the Compact price.

Dairy Compacts are supported by the American Farm Bureau, the Dairy Farmers of America, the National Milk Producers Federation and twenty-five Governors and State Legislatures, including the current members of the Northeast Compact (Vermont, Massachusetts, Maine, Rhode Island, New Hampshire, Connecticut); Northeastern States who have agreed to join the Northeast Compact (Pennsylvania, Delaware, New York, Maryland, New Jersey); and Southern States who have agreed to form a Southern Compact (Virginia, Georgia, West Virginia, Mississippi, North Carolina, Arkansas, South Carolina, Kansas, Alabama, Oklahoma, Louisiana, Tennessee, Missouri, Kentucky).

I have been working with my colleagues in the Senate for many years to assist our dairy farmers. On February 13, 1997, in an attempt to bring greater stability to the dairy market, I introduced a Sense of the Senate Resolution which passed by a vote of 83-15. The Resolution stated that the Secretary of

Agriculture should consider acting immediately to replace the National Cheese Exchange as a factor to be considered in setting the Basic Formula Price for Dairy. I successfully attached an amendment requiring the Department of Agriculture to replace the National Cheese Exchange with a systematic national survey of cheese producers to the 1997 Supplemental Appropriations Bill, which was signed into law on June 12, 1997.

Unfortunately, this action alone is not sufficient to bring long-term stability to the dairy market. Consequently, on April 17, 1997, I introduced legislation to require the Secretary of Agriculture to use the price of feed grains and other cash expenses in determining the basic formula price for milk. Further, on September 9, 1997, I joined with Senator Feingold of Wisconsin in introducing S.Res.119, which urges the Secretary of Agriculture to set a temporary minimum milk price that is equitable to all milk producers nationwide and provides price relief to economically stressed milk producers.

During the 106th Congress, we dedicated much time working to find a solution to the urgent problem faced by our nation's dairy farmers. On April 27, 1999, I joined with Senators Jeffords and Leahy in introducing legislation to reauthorize the Northeast Dairy Compact. The legislation currently has 40 cosponsors. On August 4, 1999, fifty-three Senators voted to invoke cloture on Senator Jeffords amendment to the FY2000 Agriculture Appropriations bill that would extended the current Dairy Compacts for one year. Further, I worked with Senator Jeffords and many other Senators to include a provision in the final Agriculture Appropriations bill that allowed the current Dairy Compact to continue and required the Secretary of Agriculture to use OPTION 1A for reforming the Milk Marketing Order System, thereby ensuring that dairy farmers nationwide would not loose in excess of $200 million annually.

However, as we can see by the steady decrease in dairy prices, these actions alone are not sufficient to assist dairy farmers. We must take immediate action to enhance the safety net for dairy farmers. I look forward to working with you during the next several months as we work to expand Dairy Compacts and focus on other actions to provide the assistance necessary to ensure the future viability of our nation's dairy farmers.

Testimony of Senator Rod Grams
Before the Senate Agriculture Committee
February 8, 2000

Mr. Chairman and members of the committee, thank you for the opportunity to address you today concerning the critical issue of federal dairy policy. It is my hope that these hearings will shed light on the unfair, outdated pricing structure that we currently live under and help turn the tide in our country to free markets for our dairy farmers.

Mr. Chairman, I want to first point out today that milk as a beverage competes with a host of other beverage choices for the consumers' dollar. In 1998, each American consumer drank 23.8 gallons of fluid milk products. That is compared to 56.1 gallons of soft drinks, 15 gallons of fruit juices, and 13.9 of bottled water. In fact, per capita beverage milk consumption has declined from 28.6 gallons in 1975 to 23.9 gallons in 1997. Our federal pricing policies also run counter to the conventional wisdom that we need to be promoting milk consumption as an important part of a healthy diet. If we continue to artificially raise milk prices we cannot expect farmers to be successful in the long run competing against other beverages available in the grocery store. Our dairy policy must be focused on permitting farmers to capture additional market share, both domestically and internationally.

That is one of the reasons I have introduced legislation, Senate bill 1930, which would eliminate the federal milk marketing orders and allow farmers to compete in the free market. Eliminating the milk marketing orders would end the regional price discrimination that hamstrings Upper Midwest dairy producers, and would obviously benefit the consumer, especially low income families with children that need milk for good health and spend a high percentage of family income on food. The milk marketing orders artificially inflate prices for beverage milk and other dairy products within a region, which prevents producers from lower cost regions such as the Upper Midwest from penetrating markets in other areas.

Not only does it keep Upper Midwest producers from increasing market share in other regions with lower cost, high-quality milk, but the federally mandated higher prices for fluid milk in other regions stimulate production there, resulting in more milk flowing into the production of manufactured dairy products, which depresses prices that Minnesota producers receive. The adverse effects of milk marketing orders on Minnesota farmers are two-fold.

In fact, the milk marketing order system, while raising the price farmers receive for beverage milk, actually depresses the prices farmers receive for manufactured dairy products. And the Upper Midwest Federal Order used only 13% of its milk as beverage milk in January 1999, with the remaining 87% going to the production of manufactured dairy goods. Without federal orders, Upper Midwest farmers would receive a higher price on the 87% of its milk used for processed products. How can Congress possibly justify artificially raising the price farmers receive for fluid milk, and depressing the price they receive for processed products? It can't. Congress absolutely should not be picking winners and losers in such an arbitrary manner. Minnesota farmers don't want special advantages, they simply want the heel of an antiquated system off their neck.

No other consumer food product is micro-managed as much in America as is dairy. As our colleague Phil Gramm memorably put it last year, "dairy compacts would make a Soviet commissar blush." The same goes for the U.S. milk marketing order system. The communist countries used to price goods and services using complicated formulas representing estimated values of inputs. Like federal milk marketing orders, it had little to do with supply and demand.

My bill would allow the production of milk in the United States to be based on a fair playing field for all producers. Would that be good for the Upper Midwest? Absolutely. Would it be good for the consumer and American agriculture, also? Sure. The Upper Midwest is blessed with natural conditions conducive to milk production, including a favorable climate, low feed costs, and ample water supplies. We are the most competitive producers in the country. The American consumer should be able to reap the benefits of Minnesota's abundant dairy production just as it reaps the benefits of low cost and favorable conditions for the production of oranges in Florida and potatoes in Idaho, for example. And Minnesota dairy farmers certainly should not be arbitrarily locked out of market opportunities through milk marketing orders and dairy compacts.

Deregulation is far preferable to the current system which has arbitrarily carved up markets and put regions of our country at each other's throats over dairy policy. It is instructive that while Congress grapples with how to help farmers who are suffering due to low commodity prices, it is certainly not looking to federal dairy policy as a model for reform.

Mr. Chairman, Congress needs to think long and hard about where our federal dairy policy is headed. What many members think is good for their state industry in the short-term is likely to make us all uncompetitive for the consumer's dollar in the long-term. With the ability to preserve and transport dairy products rapidly and safely around the country and practically around the world, where is the logic in a system of milk marketing orders and dairy compacts that supposedly guarantee the supply of milk products to specific geographic areas within our country? It is certainly no way to equip American dairy farmers to compete in a global economy in the 21st century.

On that same note, I hope that this committee ends it hearings tomorrow with a new resolve to eliminate the ostensibly temporary dairy compacts that have driven up the costs of beverage milk for low-income consumers, created an oversupply of dairy production in the Northeast, and consequently depressed prices that producers receive in the Upper Midwest. I am constantly forced to combat the dairy myths that proponents repeat so often until, like urban legends, people believe them to be true. Contrary to compact supporter claims, a dairy compact is ***not*** necessary to provide consumers a consistent supply of fresh milk, it absolutely does ***not*** hold milk prices down, it does ***not*** keep small farms from going out of business, it is ***not*** a states' rights issue, it ***does*** impact Midwestern markets, and it ***does*** increase the cost of living for low-income families.

Dairy compacts are rooted in the same policy assumptions that led to massive overproduction of milk in the 1980s and billions of dollars of federal expenditures to purchase and dispose of the surplus and spent billions more in a huge dairy herd buyout program. Is there nobody here that remembers that? If people do remember, you should be able to support reform. Again, are we really willing to sacrifice our opportunities to be globally competitive by adhering to policies that cause tremendous overproduction in regions that are not cost-effective in dairy production in the first place?

Finally, Mr. Chairman, I want to once again thank you for taking the initiative to hold these hearings. I hope that this is another step toward taking American dairy policy out of the shackles of Depression-era policies and assumptions and into the realities of today's marketplace. I urge your committee to report out legislation early this year that would reform dairy policy. We wanted to include dairy during Freedom to Farm, then saw it punted to USDA which came up with a compromise that was quickly reversed by the Congress; again, imposing a policy where a government program picks winners and losers, a program where hard work, good practices, and efficiencies mean nothing. Is this really what we expected during the Freedom to Farm debate? I think not.

Would you sell computers for less because they were made in Minnesota? Or can Dell Computers sell their equipment for more because they are located in Texas, more than a thousand miles from Eau Claire, Wisconsin.

Would you pay farmers more to try to grow oranges in Minnesota? Why not? If cost is no object, efficiencies don't matter and we could create an orange juice marketing order system. So what if consumers had to pay more? And while we're at it, why not create a compact, a Midwest orange compact where we would not have to compete with Florida or California? Why not protect the small orange farmer in Minnesota? An average grove of under 50 trees its not a way of life now, but 65 years from now, billions of federal dollars an unfair orange policy could make it so. If not-tell me why?

In all due respect this inequity cannot be continued. I'm angry as hell and if this Congress believes we will sit back and allow Moscow programs to be imposed and kill our dairy industry in the Midwest, the best dairy environment in the country, we will not-- unless you can give us an orange compact.

In all due respect, this inequity cannot continue. I look forward to working with your committee to achieve dairy reform that works for all regions of the country – and I hope that we can do it this year.

News from

HERB KOHL

United States Senator
Democrat of Wisconsin

330 Hart Senate Office Building • Washington, D.C. 20510 • (202) 224- 5653

FOR IMMEDIATE RELEASE: February 8, 2000
Contact: Lynn Becker or Jessica Catlin Phone: (202) 224-5653

Testimony of Senator Herb Kohl
Senate Agriculture Committee Hearing on Dairy
February 8, 2000

Mr. Chairman and members of the Committee, thank you for holding these hearings today. Also thanks to the witnesses who have come a long way to help us sort out our antiquated and unfair dairy pricing system.

Mr. Chairman, there are those who think these hearings are meaningless. They argue that Wisconsin dairy farmers need justice, and we are just giving them words. They point to the long history of back room deals and last-minute betrayals that have tilted our current dairy laws hopelessly against the family farmers of the Upper Midwest.

Mr. Chairman, I am not ready to give up on my colleagues in Congress yet. I continue to hope that they will side with us when they come to understand how far our dairy pricing system has strayed from the basic American principle of honest pay for honest work. Last year, when we forced the Senate leadership to look at our argument – literally by barring the door – we got strong and open commitments from the Majority and Minority Leaders to fight the regional dairy price fixing cartels known as dairy compacts. This year, with hearings like this, with legislation I hope this Committee will report, and through the efforts of those of us from the Midwest committed to this fight, we can change more minds.

The current pricing system is like a vampire. It cannot survive in the light of day.

So I am not ready to give up on Congress. And I am certainly not ready to give up on the struggling family dairy farmers of my State. Right here, I have a list of the 10,519 dairy farmers who stopped milking over the last three years. If this were farmers ruined by a natural disaster, then it would be a list of those eligible for FEMA loans and grants to rebuild their businesses. If this were farmers put out of business by unfair trade practices in other countries – dumping or trade barriers – then it would be a list of those eligible for trade adjustment assistance. But because their ruin was brought on by an unfair policy intentionally imposed by their own federal government, this is just a list -- a sad, sad record of a way of life that should not have to die.

Mr. Chairman, we in the Upper Midwest are not asking for a bailout. We are just asking that Congress end a dairy pricing system that is uncompetitive and un-American. The facts are clear.

One -- Increased prices in some regions – either through Compacts or Federal Orders -- results in overproduction that lowers prices for farmers outside the protected region. History shows this to be true.

Two -- Dairy compacts are an unprecedented price fixing scheme contrary to the principles of free markets that have made America's economy the strongest in the world. We built this country on the idea that, if you make a good product, you can sell it anywhere. Are we going to start creating syrup compacts that keep out Vermont syrup producers? Cotton compacts that exclude Mississippi cotton? Dairy compacts are not how we do business in this country.

Three -- The way to end regionalism and divisiveness is not to expand Compacts and exacerbate milk price distortions, but to develop and enact policies that help all farmers equally. Those who suggest we can have a national dairy policy to help all farmers and regional policies like Compacts are wrong.

Mr. Chairman, it is ironic that the Midwest is often accused of regionalism for opposing policies which help only other regions. The Upper Midwest has never sought special treatment -- we've only sought a level playing field.

We need a national dairy policy that will help all family dairy farms throughout the nation -- that will neither distort markets nor tax consumers. And we need you, Mr. Chairman, and the members of your Committee, to commit to pursuing that goal and pursuing it openly. Congress should never again agree to a last-minute special interest dairy deal that goes against every basic principle of fairness and American free enterprise.

# # #

RON KIND
THIRD DISTRICT, WISCONSIN

COMMITTEE ON EDUCATION
AND THE WORKFORCE

COMMITTEE ON RESOURCES

Congress of the United States
House of Representatives
Washington, DC 20515

1713 LONGWORTH BUILDING
WASHINGTON, DC 20515
(202) 225-5506

EXCHANGE BUILDING
205 5TH AVENUE SOUTH, SUITE 227
LA CROSSE, WI 54601
(608) 782-2558
TOLL FREE 1-888-442-8040

131 SOUTH BARSTOW STREET, SUITE 301
EAU CLAIRE, WI 54701
(715) 831-9214

U.S. Rep. Ron Kind

Senate Committee on Agriculture
Tuesday, February 8, 2000

Thank you Chairman Lugar, Ranking Member Harkin, and other distinguished Senators for holding this important hearing regarding the plight of our nation's dairy industry. Your interest and desire in improving the domestic dairy industry is much appreciated.

The dairy industry is one of Wisconsin's leading industry. In 1998, approximately 22,000 dairy farmers produced 22.8 billion pounds of milk. Gross milk receipts for 1998 were approximately $3.5 billion. Roughly 160,000 people are employed in our state's dairy industry. Eighty-five percent of Wisconsin's milk is processed into cheese and other manufactured products. Wisconsin cheese is nationally and internationally renowned.

In the past few years, however, Wisconsin, like nearly every other state, has seen a tremendous exodus of farmers from the dairy industry. While much of the farm loss can be attributed to structural changes occurring within the industry, we cannot forget the impact that this nation's discriminatory federal milk marketing order pricing system and lack of international trade opportunities has on the average Wisconsin dairy farmer's balance sheet.

Mr. Chairman, much attention has recently been given about the fallout from the World Trade Organization (WTO) talks in Seattle. Specifically, many within the agriculture industry believe that not enough was done to reduce tariffs and other barriers to trade and expand market access for U.S. agriculture products.

Unfair blame has been directed toward U.S. Department of Agriculture Secretary Dan Glickman and U.S. Trade Representative Charlene Barshevsky regarding our agriculture trade woes. Blame, however, should not be placed squarely on their shoulders. After all, it is Congress, not the Administration, that permits the continuation of a byzantine federal milk marketing order system that favors one region of the country over another. It is Congress, not the Administration, that during the Fall 1999 sought to extend the life-support for a six-state milk pricing cartel that increases the price for fluid milk products for consumers and the government.

Ironically, just months before the Seattle WTO summit, the House passed a bill that replaced the U.S. Department of Agriculture's (USDA) market-oriented reform with a water-down version of the 60-year plus milk pricing system that favors those in the Northeast and Southeast. Not surprisingly, industry representatives from those regions of the country that benefit from the non-market oriented current pricing policy opposed USDA's plan and showered Congress with pleas to maintain the status quo even though it was the failures in the federal milk marketing order system that led to the farmers demise.

In December 1998, I, along with Senator Pat Roberts -- a distinguished member of this Committee -- traveled to Brussels and met with members of the European Union's agriculture commission. There the Europeans told us that America's demand for the EU to lower their domestic and export subsidies and their import tariffs was hypocritical due to our nation's long desire to maintain our federal milk marketing order system.

According to a June 1999 report submitted by the Netherlands Ministry of Agriculture, Nature Management and Fisheries, "[T]he FMMOs (Federal Milk Marketing Order System) result in a consumer-financed subsidy of about $500 million a year to dairy farmers. This form of cross-subsidisation allows the American dairy sector to sell its butter, cheese, and milk powder at a lower price on the domestic market and on the export market. In view of WTO regulations, the FMMOs are controversial, to say the least." Mr. Chairman, why is it that members of Congress have no problem pointing out the flaws of the Europeans when it comes to domestic subsidies but we cannot acknowledge our own.

Wisconsin's dairy industry is not afraid of the international marketplace. In fact, my state's dairy manufacturers are equipped to sell specialized dairy products to any consumer, wherever he or she may live. While there are only so many things that Congress can do to assist, opening new markets and removing outdated and unnecessary domestic and international trade impediments are the most important.

Mr. Chairman, over the next two days, a number of industry representatives from those regions of the country that benefit from the non-market oriented current pricing policy will appear before your committee. I urge you to see through their arguments.

Without question, America's dairy farm families are enduring an unprecendented financial crisis with the price of raw milk at the 1978 level. This problem will not be resolved by creating new, regionally beneficial program that help some and harm others. Instead, any new pricing system must be fair, equitable, and best position the U.S. dairy industry for the economic challenges of the 21st century.

Thank you for the opportunity to appear this morning. I would be happy to answer any questions the committee may have.

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TESTIMONY OF

THE HONORABLE PAUL WELLSTONE

UNITED STATES SENATOR

BEFORE THE SENATE COMMITTEE ON

AGRICULTURE, NUTRITION AND FORESTRY

FEBRUARY 8, 2000

Mr. CHAIRMAN. On behalf of Minnesota's 8,700 dairy farmers, I would like to thank you for holding these urgent hearings on our national dairy policy. In this time of seemingly unparalleled economic prosperity, record low unemployment and skyrocketing corporate profits, there is a large segment of our population who have been left behind -- America's family dairy farmers.

Dairy issues are important in many states, but few can claim that the health of their state's dairy industry is of vital importance to their state's economy. In my state of Minnesota, dairy production is truly one of the cornerstones of our economy. While I have spoken in the Senate many times about the importance of family dairy farming to my state's economy, allow me to highlight some important facts about Minnesota's family dairy farmers. We have 8,700 diary farms in Minnesota, ranking us fifth in the nation in dairy production. The milk production from Minnesota farms generates more than $1.2 billion for our states' farmers each year, and a recent University of Minnesota study determined that dairy production in Minnesota creates an additional $1.2 billion in economic activity for related industry.

Despite the large amount of dairy production, the average herd size of a Minnesota dairy farm is about 60 cows. Sixty cows per farm, so we are really talking about family operations in my state. Minnesota's family dairy farmers are small businesses with a total of $ 1.2 billion in sales a year. They are contributing to their small town economies, trying to live a productive life on the land. Family agriculture is not just an important element of our states heritage, it is vital to our future. Sustainable rural communities need family farmers. The environment needs family farmers.

However, like the rest of the family farmers in this country, Minnesota's dairy farmers are facing a crisis. When I use the word crisis in dairy, I want to be clear I don't use the word lightly. Minnesota is losing dairy farms at the rate of three per day due to base prices that are already low and unstable.

There is such volatility in the market, it is no question why our farmers are having a difficult time to survive.

In my visits to Minnesota dairy farms this past year I have witnessed a frustration and desperation that matches the worst times felt on Minnesota farms during the crisis of the 1980's. Our dairy farmers simply cannot survive in business under the current condition. I'd like to share just one of the hundreds of stories I've heard from family dairy farmers who are hurting. Les Kyllo is a dairy farmer from Goodhue, MN.

- *My grandfather milked 15 cows. My dad milked 26. I have milked as many as 100 cows, and I'm going broke. They made a living out here and I didn't. Since my son went away to college, my farmhands are my 73-year-old father and my 77-year-old father-in-law who has an artificial hip. I have a barn that needs repairs and updates that I can't afford. I have two children that don't want to farm. At one point, in a 30-mile radius, there were 15 Kyllos farming. Now there are three. And now I'm selling my cows. My family has farmed since my ancestors immigrated to the United States. When I leave farming, my community will lose the $15,000 I spend locally each year for cattle feed; the $3,000 I spend at the veterinarian; the $3,600 I spend for electricity; or the money I spend for fuel, cattle insemination and other farm needs.*

This is just one story. I read this story, because it is important that when we consider national dairy policy here in the Senate, we need to keep in mind that we are determining the future of an industry and a way of life that are basic not only to the agricultural economy, but to the very soul of America's rural heartland.

Minnesota is not asking for special favors. All Minnesota dairy producers are asking for is a fair shot, and with the volatility of the market family farmers cannot compete. Let us examine the Basic Formula Price (BFP), which is the monthly base price per hundredweight paid to dairy farmers for their milk, over the last year. In August of last year the BFP was $15.79 per hundred weight. That was quite high and it's a good price. Farmers could be pleased with that price. In September the BFP rose a little higher to $16.26 per hundredweight. Back in May of 1999, the BFP was only $11.26. Some have argued that it was due to the drought in the East that prices rose so high for August and September. The milk price was high because cows in the eastern region were strained and produced less milk. Therefore, milk was in demand and thus the price rose. If this is the case, our farmers were getting a decent price for their milk, only at the expense of farmers in other parts of the country who are suffering.

In October, the BFP took a tumble from the $16.26 per hundredweight to the September price of $11.49 per hundredweight. This is a dramatic drop price. And again the BFP continued to drop in November and December down to $9.63 per hundredweight. While the recently announced price of $10.05 per hundredweight is an improvement, it is hardly enough for families to live on. Again, as I have stated before, with such an erratic market, there is no question why our farmers are having a difficult time to survive.

USDA statistics show that between 1993 and 1998, Minnesota lost 3,800 dairy farms. That represents 28 percent of our 1992 total, and a loss second only to Wisconsin among all 50 states. Taking a broader look at the Upper Midwest states, including Minnesota, Wisconsin, Iowa, Illinois, Nebraska, North Dakota and South Dakota, our region lost 49 percent of all the US dairy farms lost between 1992 and 1998. These are not just statistics, these are people's lives and the survival of our rural communities. I am sure that there is no committee in Congress more aware of the precarious state of rural America's economy than this one. So it is enough for me to simply mention that we cannot afford to be driving hundreds more dairy farmers out of business.

And if family dairy farmers are not struggling enough with the volatility of the market, last year Congress assisted and in some cases may have made the price for many dairy farmers worse - and that is what has happened with the Northeast Dairy Compact. The Northeast Dairy Compact gives six states the right to join together to raise prices to help producers in the region. While it may help the Northeast, it is cutting into other markets.

Yet, ironically, the 1996 Freedom to Farm bill was passed with the intent to remove government from the marketplace. Although I adamantly opposed the bill, many viewed the 1996 Farm bill as a way to decouple payments to family farmers. The thought at that time was that farmers should produce for the market and that Congress should eliminate a safety net for our farmers.

The Northeast Dairy Compact fixes fluid milk prices at artificially high prices for the benefit of dairy producers in just that region. This artificial price boost of a compact may benefit the producers covered by the compact, but it hurts all other dairy farmers.

For some reason, we seemed to play by a different set of rules when it comes to dairy. We told our corn and soybean farmers that to succeed in the 21st century they should pay close attention to market signals, but at the same time we implemented compacts that drown out those signals for dairy farmers. And yet even among dairy producers, we scrutinized and allowed only one region of the country to provide a safety net for their farmers, while hurting farmers in other parts of the country.

It is true that the Compact provided a safety net this spring to certain farmers when dairy prices plunged. When the price of raw milk dropped by 37 percent, one Massachusetts farmer got a $2,100 check from the Compact. Overall, that farmer said, aid from the compact totaled seven percent of his gross income during the first 12 months of its operation. Conversely, Midwest dairy farmers-- who also confronted the sharp price decline -- got no such payments.

It is also no secret that the extension of the Northeast Compact has encouraged other regions such as the Southeast to form their own compact. This would be detrimental to the Upper Midwest. A recent report by University of Missouri dairy economist Ken Baily found that Minnesota's farm-level milk price would drop at least 21 cents per hundredweight if a Southeast dairy compact were allowed to be implemented alongside expanded Northeast dairy compact. This would translate into a $27.2 million annual reduction of Minnesota farm milk sales. The compacts in Baily's study would cover only 27 percent of U.S. milk production, yet would have a sizable negative impact. If more regions adopted compacts Minnesota prices would drop even further.

Many inquire why the Upper Midwest doesn't form their own compact. Minnesota and Wisconsin farmers would not benefit from organizing their own compact. A compact's price boost applies for only fluid milk. The percentage of Upper Midwest milk going into fluid products is so low that any compact would do little for Minnesota's farmers' income. The negative impact of compacts would far outweigh any minimal boost to fluid prices here in Minnesota.

However, the dairy language attached to last year's omnibus bill goes even further and will hurt not only Minnesota dairy farmers, but frankly dairy farmers throughout the country. What I am concerned about, as are many Americans, is the trend towards factory-farm and concentration in dairy. H.R. 3194 established a pilot program allowing for the expansion of forward contracting of milk.

Forward contracting reduces competition in the marketplace and results in lower prices to dairy producers. Forward contracting is not specific to the dairy industry. In fact, one can note the effect of forward contracting by the current events occurring in the hog industry. Recently, the hog industry has witnessed a significant increase in the number of producers who decided to forward contract. Hog producers will contract with packers to guarantee them a minimum price for their pigs. Contracting is not inherently bad and there are some good contracts. However, what is now occurring is that these deals are made often in private and do not reflect the spot market. There is a strong argument that contracting is partly responsible for the depressed hog prices and the rapid increase in the consolidation of the hog industry. What is happening in the hog industry is also happening in dairy.

This provision expanded forward contracting of milk by allowing processors to pay producers less than the federal milk price for milk. Under past law, forward contracting was allowed, however, only if the buyer was willing to offer at least as much as the federal minimum price. In other words, this provision removed an important safety net for our dairy producers.

Expanded forward contracting can also reduce the price for producers who do not forward contract by reducing the competition for milk, thereby damaging the entire dairy market structure. This provision also discriminates against our family farmers because processors are likely to offer forward contracts to the largest producers. Again, we would see the domino effect of losing family farmers. By giving a better deal to larger producers, our family farmers cannot compete and we would see more losses of family farmers.

Those who support forward contracting contend that it is a risk management tool; however, this argument doesn't hold water. In fact, National Farmers' Union and other groups contend that forward contracting will actually make it more difficult to manage risk by forcing producers to guess whether the volatile dairy market will go up or down. It can be logically deduced that in the absence of an adequate support price, the market will continue to be highly volatile. What can happen is that anytime producers price guess wrong, they lose money under this proposal.

The truth is that our family dairy farmers cannot compete in such a volatile market place. We must set policy that keeps family dairy farms in business while ensuring that consumer and taxpayer costs are kept at a reasonable level. What we need to achieve here is a fair, sustainable and stable price system for ALL dairy farmers.

It is bad enough that the extension of the Northeast Dairy Compact was attached to the omnibus bill last year, but it was unacceptable for Congress to meddle with USDA's final plan by resurrecting an alternative similar to Option 1-A. This country deserves milk pricing reforms that more accurately reflect the current market conditions, and are fair to producers and consumer alike.

Given the prominence of Minnesota's dairy industry, it should be no surprise that I have pushed for reform of the milk pricing system. Last year the Secretary's reforms were a step forward in a long overhaul of dairy policy toward a more unified and simplified pricing system that benefits all producers. We need to reduce and eliminate the regional inequities that exist within the federal order system. The current pricing system regulates the price of fluid milk based on the distance from Eau Claire Wisconsin. This policy causes market distortions that disadvantage producers in the Upper Midwest. Equitable milk pricing reforms must move forward quickly.

Mr. Chairman the dairy provisions enacted last year are putting dairy farmers at great risk not just in my state, but across the country. It is imperative that we establish a national and equitable dairy system for all. It's my hope that we can work together to establish a fair national milk pricing policy, one that recognizes the need for a national safety net to help producers through times of low prices and that will end over half a century of discrimination against the Midwest. Thank you.

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MARK GREEN
8TH DISTRICT, WISCONSIN

ASSISTANT MAJORITY WHIP

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING AND FINANCIAL SERVICES

COMMITTEE ON THE BUDGET

COMMITTEE ON SCIENCE

REPUBLICAN POLICY COMMITTEE

Testimony of Congressman Mark Green

Senate Committee on Agriculture, Nutrition, and Forestry

February 8, 2000

Thank you Mr. Chairman.

Mr. Chairman, I'm honored to have this opportunity to offer a few thoughts on what is taking place in our nation's dairy industry. This is obviously an issue of great importance to consumers and dairy producers all across America. Rest assured, it is an issue of survival to dairy producers in the upper Midwest.

Over the next two days, as I understand it, you are going to broadly examine the government's role in our nation's dairy policies. I believe you will find clear evidence that federal regulations, including our current milk marketing orders and the Northeast dairy compact, are having a dramatic negative impact on Midwestern dairy farmers.

Mr. Chairman, as we all know, farmers all across the nation are suffering economically. In 1999, when Congress moved to undo the United States Department of Agriculture's (USDA) very modest dairy reform rules, the effort was led by members of the House and Senate sincerely trying to address the financial pain their dairy farmers were experiencing. But what many did not realize was (a) the crisis facing upper Midwest dairy producers was and is much worse than anywhere else or (b) that overturning the USDA's modest reform plan would only extend and deepen that crisis.

At the end of 1999, the Basic Formula Price for milk fell past 20-year lows to $9.63 per hundred weight. As of last week, the price of milk had fallen nearly 30% from this time last year. But these numbers don't adequately tell the tragic story. Over the last two years, Wisconsin lost about five dairy farms each and every day (it is currently losing three dairy farms per day). In the last nine years, my state has lost over 11,000 dairy farms. Or, put another way, over the last decade, Wisconsin has lost more dairy farms than nearly any other state ever had.

1218 LONGWORTH BUILDING
WASHINGTON, DC 20515
(202) 225-5665

700 EAST WALNUT STREET
GREEN BAY, WI 54301
(920) 437-1954

609A WEST COLLEGE AVENUE
APPLETON, WI 54911
(920) 380-0061

837 CLERMONT STREET
ROOM 112
ANTIGO, WI 54409
(715) 627-1511

TOLL FREE IN WISCONSIN (800) 773-8579
www.house.gov/markgreen

Today's milk marketing order system was originally developed in 1937 when the state of Wisconsin was the largest dairy producer in the country and most states were deficit producing dairy states. In 1937, it was difficult to transport drinkable milk across the country. Price incentives were thus created to spur dairy production in deficit states. The system mandated that dairy producers receive more for their milk depending on how far their farming operation was from Eau Claire, Wisconsin.

Today we have refrigerated trucks and an infrastructure that allows us to rapidly and efficiently move milk from one region to another. More importantly, we now have 35 states producing dairy surpluses – there is no area of the US that doesn't have easy access to fresh milk. Many things have changed since 1937, but the milk marketing order program has remained the same.

As you know, the milk pricing system is one of the most difficult issues members of Congress are asked to understand. In fact, I have to rely on a little crutch to illustrate the true unfairness of the Milk Marketing Order Program. Behind me is a cartoon that I believe says it best (refer to figure 1).

I would like to ask members of this Committee if they truly believe if it makes sense to price milk based upon its distance from Eau Claire, Wisconsin or the upper Midwest? If so, should beer producers receive more for the beer they brew based upon their distance from the Anheuser-Busch facility in Saint Louis, Missouri? Should Congress mandate that poultry producers get paid more for their chickens the farther they are from Arkansas? While Wisconsin's climate is not conducive for orange production, we could produce oranges if the government subsidized us enough.

The real question is whether or not any of this makes economic sense. If you answer yes, then support our current dairy policy. But if you believe it is fundamentally wrong to price a product based upon its distance from a surplus producing area, then you recognize the need to reform this inequitable and obsolete system.

Furthermore, at the very time when America is pushing countries all over the globe to open their markets and drop trade barriers, how can we possibly defend maintaining artificially imposed economic barriers for dairy trade between the states? At best, it is hypocritical. At worst, it may be unconstitutional.

As you are probably aware, efforts have been made to reform our antiquated dairy policies. During the debate on the 1996 Farm Bill, Congress was unable to form a consensus on dairy reform and the impasse threatened to kill this landmark legislation.

As a result, dairy interests from around the country and across the spectrum agreed to leave out dairy reforms and they directed the Agriculture Secretary to develop a reform plan with the understanding that all sides would live with the Secretary's final rule. The legislation that was added to the Fiscal 2000 Consolidated Appropriations Act directly contradicted the Secretary's rule and violated the 1996 understanding.

Furthermore, because the Secretary's dairy reforms require approval by 2/3 of dairy farmers within each new proposed order, this legislation also denied our nation's dairy farmers the opportunity to cast their vote on an issue that affects them so deeply.

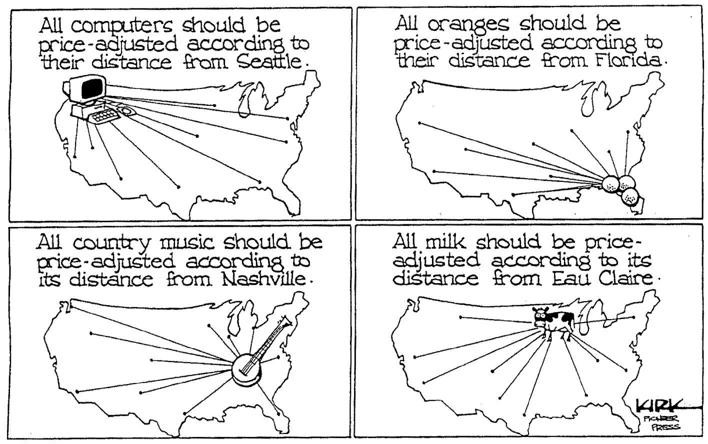
Agriculture Secretary Dan Glickman's attempted reforms to the Federal Milk Marketing Order program were modest – very modest from the perspective of Upper Midwest dairy farmers. However, the Secretary's proposal would for the first time in the 62 years of the Milk Marketing Order system move toward a more market-oriented dairy system that benefits the taxpayer by lowering the price of milk.

Unfortunately, as I have just alluded to, Midwestern farmers aren't the only losers with our current dairy policies. A 1995 Congressional Budget Office report indicated that reform of the Milk Marketing Order program could save taxpayers $149 million annually. In fact, the Milk Marketing program is the third program mentioned in Citizens Against Government Waste's ***"Prime Cuts" Summary of Forty-Four Ways to Leaner Government.*** This system also hurts taxpayers by reducing the strength of basic support programs like WIC. Nonpartisan groups like Citizens Against Government Waste and Americans for Tax Reform agree that efforts to maintain this system are anti-taxpayer.

The Northeast Dairy Compact is another component of our dairy policy that is increasing the burden on both Midwest producers and consumers nationwide. Compacts are little more than multi-state cartels that artificially inflate the price of milk by limiting competition from more efficient producers outside the compact area.

Compacts establish a minimum price for milk that processors must pay dairy producers in the compact region. Processors within the compact are prohibited from buying milk from producers outside of the compact region at a lower price than the minimum compact price, and they prohibit processors outside the compact from shipping milk into the compact area unless the processor paid at least the minimum compact price. This amounts to nothing more than a milk tariff imposed by one state or compact region on another region. Instead of facilitating commerce between the states it creates economic protectionism at the expense of national consumers and healthy competition.

Dairy compacts increase the costs to consumers in the compact region and drive down consumption rates of dairy products. Recently, economists have indicated that a 10 percent increase in the retail price of milk can lead to as much as 8 percent decline in milk consumption. When the Northeast Dairy Compact was established consumers were required to pay an additional $.22 per gallon of milk. According to the Consumer Federation of America, if the Northeast Dairy Compact is extended and a Southern Dairy Compact is authorized consumers can expect to pay an additional $485.2 million for the milk they drink in the first six months of the compacts. These increased costs will result in declines in milk consumption rates.



WHICH OF THESE IS ACTUAL FEDERAL POLICY?

TESTIMONY OF CONGRESSMAN PAUL RYAN BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY - February 8, 2000

Thank you, Mr. Chairman. Good Morning.

Mr. Chairman and Members of the Committee, I am grateful for the opportunity to testify before this Committee today because the Congressional district I serve, as well as the whole state of Wisconsin, is suffering great losses every year because of the current Federal Milk Marketing Order and the continuation of the Northeast Dairy Compact. Wisconsin lost over 11,000 farmers in Wisconsin between 1990-1998. In the Congressional district I serve alone, which is located in Southeastern Wisconsin, we lost over a third of our dairy farms during the same period. Wisconsin has been losing for decades because of a Depression-era price control structure that penalizes farmers who live too close to Eau Claire, WI. With the current drop in dairy prices, we stand to lose many more farmers.

The current dairy pricing system allows the government to replace the free market by setting prices. Certain farmers are artificially disadvantaged because dairy farmers in other, less efficient areas of the country are being guaranteed an unduly enhanced price. This system of discriminatory pricing encourages overproduction and surpluses by rewarding farmers in areas of the country that may not be able to efficiently operate a dairy farm. It also encourages farmers in certain regions that receive higher payments, due to either the Federal Milk Marketing Order or the Northeast Dairy Compact, to produce more milk than is needed.

These surpluses drive down the price for our milk and eliminate markets for farmers in the State of Wisconsin and in the Midwest. Given the fact that Midwestern farmers already receive far less for their milk than farmers in the rest of the country, when farmers in other parts of the country are suffering losses, Midwestern farmers are barely getting by. This punitive system of paying farmers based on where they live is one that no longer has a place in this country.

The work of farmers in all parts of the country should be rewarded. Currently, producers in Florida are rewarded with differential payments that are twice as much as what producers in Midwestern states, such as Minnesota, are being paid. How can such a system be justified? If we really believe that in Florida it costs twice as much to milk a cow as it does in Minnesota we owe it to the consumers of America to explain why this Congress would support paying a farmer in Florida twice as much to stay in business.

The farmers in Wisconsin and Minnesota should not be penalized for where they have chosen to live. Nor should the consumers in other parts of the country be penalized at the grocery stores because of where they live.

Organizations ranging from taxpayer groups such as the Council for Citizens Against Government Waste, to food industry organizations such as Food Distributors International and International Foodservice Distributors Association (representing 234 member companies and 791 distribution centers), as well as the Teamsters Union, were opposed to the recent congressional action to undo the USDA's attempt at market reform. Consumer groups such as Consumer Federation of America have determined that the current dairy pricing system penalizes consumers. Think tanks and consumer groups have identified the current milk pricing system as an unfair "tax on consumers". It is not often that you find so many diverse groups in agreement on an issue.

The CATO Institute states that consumers who buy fluid milk lose the most from the price discrimination in the current system. According to CATO analysis of the current system, which cites estimates by economists Peter Helmberger and YuHui Chen, the federal milk marketing order system led to consumers paying 13% more for fluid milk than they would in an unregulated market. According to CATO, Helmberger and Chen estimate the losses to milk consumers at just over $1 billion per year. Although consumers gain lower prices for manufactured dairy products due to the order system, they estimate that gain to be only $600 million, creating an annual net loss to consumers of $400 million per year in higher prices.

Newspapers all over the country have written editorials opposing the current pricing system. The Kansas City Star referred to it as "dairy socialism". In a September 14, 1999, editorial the Dallas Morning News told Congress that "monkeying with the free market has raised prices for consumers and hasn't kept marginal dairy farms from going bankrupt." In a July 29, 1999, editorial, the Chicago Tribune called the current system "domestic protectionism" and criticized this Congress for creating internal regional trade wars by allowing this system to continue. It went on to say that we as a nation are justified in accusing Europe of protectionism "when it comes to beef and bananas. But when lamb and milk are on the menu, the accuser stands accused."

It has become clear to many people in this country that this is a system that may have been appropriate in the 1930's, but the need for it has come and gone. Advances in technology and transportation have simply eliminated the need for this system. In the 1930s, certain areas of the country were surplus regions while others did not have an adequate milk supply. The modern refrigeration and transportation methods that exist today had yet to be perfected. The system was designed to encourage farmers in low production areas to produce more milk and compensated farmers in high production regions for the transportation costs that they would incur. Today, this system is unnecessary.

In 1996, Congress recognized that this system has outlived its usefulness and required the experts at USDA to reform the Milk Marketing Order in a fair and equitable manner. This was a wise decision by Congress. The only objective of the USDA was to create a more fair and equitable system based on market forces.

The USDA met the challenge given to it by Congress in 1996 last year. The reformed system would have allowed the market to work with fewer distortions while still providing for some price discrimination for producers and ensuring an adequate supply of fluid milk. This reformed order system was an attempt to equalize conditions across all regions of the country. The USDA worked hard to ensure the affects to all regions would be minimal.

There are approximately 90,000 dairy farmers in America, around 40,000 in the Upper Midwest; I join those farmers in expressing my disappointment and frustration with the actions of this Congress and the sudden policy change by this administration in 1999 to thwart reform and preserve the Northeast Dairy Compact and the current horse and buggy pricing system. I join my colleagues from Wisconsin and the Upper Midwest in urging this Committee to reexamine the system Congress has created.

Thank you again, Mr. Chairman, for taking this opportunity to look into this issue further. I am happy to answer questions you or the committee may have.

Basic Formula Price (BFP) = [last month's average price paid for manufacturing grade milk in Minnesota and Wisconsin + [current grade AA butter price X 4.27 + current non-dry milk price X 8.07 – current dry buttermilk price X 0.42] + [current cheddar cheese price X 9.87 + current grade A butter price X 0.238] – [last month's grade A butter price X 4.27 + last month's non-dry milk price X 8.07 + last month's dry buttermilk price X 0.42] – [last month's cheddar cheese price X 9.87 + last month's grade A butter price X 0.283] + (present butter fat – 3.5) X [current month's butter price X 1.38] – [last month's price of manufacturing grade milk in Minnesota-Wisconsin X 0.028]].

Blend price formula = (basic formula price + .12) X (percent of milk used for cheese powder and butter) + (basic formula price + .30) X (percent of milk used for ice cream and yogurt) + (basic formula price + 1.04 + .15 X [distance from Eau Claire, Wisconsin/100]) X (percent of milk used for fluid).

Testimony of
Commissioner Nathan L. Rudgers
New York State Department of Agriculture & Markets

U.S. Senate Agriculture, Nutrition and Forestry Committee
American Dairy Policy:
Why do we have a dairy program? What is the status of the dairy industry in America?
Tuesday, February 8, 9:00 a.m.
Hart Senate Office Building, Room 216

Good morning. I would like to thank Senator Lugar and the other esteemed members of the committee for inviting me to testify on behalf of New York's dairy farmers. Governor Pataki and the New York State Department of Agriculture & Markets were both very involved in the effort to have our State included in the Northeast Dairy Compact last year and we witnessed firsthand the difficulties that this complex issue presented to members of Congress. I commend you, Senator, and the other members of the committee for having the insight to schedule these very important hearings to learn more about how we can help our dairy farmers to receive a fair and livable price for their product, preferably without having to revisit the political battles fought on Capitol Hill last year. I would like to talk to you today about the state of the dairy industry in New York. I would also like to articulate why I think we continue to need a national dairy policy and how these two issues are related.

Congress is to be praised for having the vision and fortitude to direct USDA to change the rules by which price discovery is accomplished in the dairy industry and effectively consolidating a still vital and relevant federal milk marketing order system. Simply put, milk remains a perishable product which is difficult to value and to orderly market. The federal milk market order system accomplishes those tasks. Effective price discovery mechanisms and the orderly marketing of milk are two essential components of a healthy dairy industry in New York.

Milk and dairy products are New York's leading agricultural commodities and are processed by leaders in the cheese and soft dairy products industry. Production in 1998 totaled 11.7 billion pounds with an approximate value of $1.8 billion, 56% of our total farm gate sales of just over $3 billion. New York State ranks 3rd nationally in milk production. The approximately 8,000 dairy operations and 140 dairy processing plants in my state are interwoven through their respective communities. These statistics show how important the dairy industry is to our State.

Besides being the 3rd largest producer in the U.S., New York is part of a regional block of producers that provide much of the populous East Coast with its dairy products. New York does not stand alone in the historical importance of our dairy industry. Combined with our neighboring states, we form a regional dairy economy that is highly significant. Preliminary 1999 USDA data indicate that the northeast region produces nearly 20% of the nation's milk supply, which is comparable to the other major dairy regions of the country. Our resources are plentiful, especially water, good soils, and cool climate, our farmers are progressive, and our industry is well positioned for the future. We have an advantage in our proximity to major markets. The richest market in the world is in a 750-mile circle centered in New York State. Within this region you will find one-half of the United States and Canada's population, personal income, and wholesale and retail trade.

The state of dairy farming in New York State is one of a dynamic industry, one that is poised to use these advantages competitively in the new millenium. Our dairy farmers tell me that the regional future looks very promising; however, they need some short-term help while they position themselves in the new volatile dairy environment. Policy tools exist that Congress can provide to help our family farms transition and react to changing conditions in what is a very competitive marketplace. One of those tools is the Dairy Compact and it should be expanded to reflect the regional nature of our market. The low prices our farmers are currently receiving is the most pressing issue facing us right now, as prices are at their lowest levels in more than 20 years. On Friday, the dairy industry's benchmark price, the Class III Price, formerly known as the Basic Formula Price, was announced at $10.05 per hundredweight. While some forecasters predict that the price will increase slightly later in the year, I do not believe that some of our dairy farmers can last that long at these price levels.

On January 1, 2000, the long awaited federal order reform was finally implemented. The three formerly separate federal marketing areas in the Northeast were merged into one unified regional marketing order. After careful and extensive review, USDA determined that the northeast region from New England to Washington is one market. It would be appropriate for Congress to follow in a similar manner by permitting the Northeast Compact to be extended to cover that region.

Last year, Congress appropriated $125 million to be used to help dairy farmers. Of that, New York dairy farmers are projected to receive $11.4 million. While the assistance is certainly appreciated, if New York had been permitted to join the Northeast Compact, our dairy farmers would have received an estimated $132.6 million in Compact premiums this year, more than the entire Assistance Program itself. It does not make sense that the federal government continues to have to provide emergency stopgap assistance when a regional policy that provides a self-supporting safety net would be more effective, and would not require annual cash infusions from Congress. Joining the Northeast Compact would establish a transitional safety net for our family farms and ensure a steady and affordable supply of fresh, locally-produced milk for New York's consumers.

Frankly, it would have been preferable if USDA used the $125 million appropriated last fall in a more effective and efficient manner by linking impacts under the dairy price support program to federal milk market orders. Rather than cash payments to farmers, USDA could have used the Commodity Credit Corporation (CCC) authority to reallocate the butter-powder purchase price tilt to support nonfat dry milk at a higher level. Alternatively, USDA could have used the funds for advanced purchases of cheese for school and domestic feeding programs at market price levels, slightly higher than the current cheese purchase price. Either action would have tightened wholesale commodity markets and supported farm prices through the interaction of the federal milk market order pricing formulas. This "smart government" action would have been a more effective tool than direct payments for significantly supporting farm level milk prices. These tools are still available to USDA and Congress should encourage them to use them. Our farmers would rather have a fair price for their product than a government handout.

I applaud Congress for directing USDA to hold hearings on the Class III pricing formulas under federal milk market orders. This is an important and time-sensitive issue. As it is currently written in law, Congress directed USDA to publish a final decision on December 1, 2000 - not before or after. I would encourage you to permit USDA to issue the decision sooner rather than later.

These are some of the tools that I believe Congress could provide to New York State dairy farmers to help them remain competitive. Governor Pataki has done a tremendous job through substantial cuts in taxes and regulations which has addressed cost of production issues at the State level. A national dairy policy, one that recognizes the ability of the states to best use the market to position their farmers to remain competitive and viable, could be an effective complement to our efforts in New York State. I hope that we can count on your assistance in trying to keep our dairy industry healthy and competitive.

In closing, I should mention that I was raised on a dairy farm. I have two brothers still operating farms in Western New York. Dairy farming is something I am close to and is part of me. It is also an intrinsic part of the rural landscape, culture, and heritage of New York State. It is because of this importance that Governor Pataki and I have worked so hard and so closely with our congressional delegation to see New York join the Northeast Compact. If New York is not permitted to join the Compact, then our continued efforts to transition farmers to be more market-oriented and able to succeed in the new dairy economy will be much more difficult. I hope that these discussions today can lead us to the goal of helping our farmers succeed, and we can have healthy, prospering dairy operations throughout New York and the United States.

Thank you again, Senator Lugar and the rest of the committee, for inviting me here to testify today and I look forward to working with you as we address the issues that face our dairy industry.

U.S. Senator
TOM HARKIN OF IOWA

http://www.senate.gov/~harkin/ (202) 224-3254

FOR IMMEDIATE RELEASE: Contact: Jennifer Frost

OPENING STATEMENT OF TOM HARKIN (D-IA)
RANKING MEMBER
SENATE AGRICULTURE, NUTRITION, AND FORESTRY COMMITTEE
FEBRUARY 8, 2000
FEDERAL DAIRY POLICY

Thank you, Mr. Chairman, for calling these hearings. I would like to welcome my many colleagues from the Senate and House.

Dairy policy is an issue that is important, not just to the economic well-being of many parts of this country, but to the health of our country's population. Milk does a body good, so the saying goes.

Dairy policy was historically based on the perishable nature of milk, and the difficulty of transporting it from areas of surplus to areas of need. In the last century, the market did not work well to ensure that all areas of the country had a reliable source of fresh and wholesome milk. The market also did not work well in addressing unequal bargaining power between milk producers and processors. Therefore, the Federal Milk Marketing Order system was created. However, while the dairy market has changed a great deal since the creation of Milk Marketing Orders, the orders themselves still rely on outdated assumptions that disadvantage dairy producers in the Upper Midwest.

In the 1996 Farm Bill, Congress directed USDA to reform the Milk Marketing Order system. Last year, USDA completed its rulemaking to do just that. But then in Omnibus Budget Bill, Congress overturned USDA's carefully crafted rule and adopted a proposal that perpetuates regional pricing biases against Upper Midwest dairy farmers. That outcome was at odds with providing farmers in all parts of the country a fair shake at making it in the dairy business.

Dairy policy has never been easy, but the contentiousness and division we now see are quite discouraging. Dairy policy has become one of the most bitter regional conflicts Congress faces today. I hope these hearings can begin to find some common ground and lay groundwork towards finding an equitable, fair, and sustainable national dairy policy. A policy that is good for farmers, consumers, and processors across the country.

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When I say sustainable, I mean I am committed to finding a dairy policy that will insure dairy farmers across the country have an adequate safety net, just like all farmers should. I am not saying I believe that past dairy policy was necessarily the best way to provide income stabilization to dairy farmers. I think we need to discuss what works best in today's increasingly global diary markets. What I am saying is that we should not rip the floor out from under farmers without making sure they have something to stand on. And we should not allow some regions to protect themselves at the expense of producers or consumers in other regions.

I would hope that this new millennium could provide an end to unfair regional preferences in dairy policy. I think we can find a policy that will provide a fair dairy price structure and adequate farm safety net nationwide. I hope these hearings are a step in that direction.

Thank you Mr. Chairman.

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RICK SANTORUM
PENNSYLVANIA

COMMITTEES:
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RULES
AGING
BANKING
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United States Senate

WASHINGTON, DC 20510-3804
202-224-6324

Statement of Senator Rick Santorum
Senate Committee on Agriculture, Nutrition, and Forestry
"Review of Federal Dairy Policy"
Tuesday, February 8, 2000

Chairman Lugar, I am pleased to be here today as the Senate Agriculture Committee begins a two day discussion of dairy issues. I appreciate your leadership in focusing the committee's attention on this topic as the dairy industry is an important contributor to our nation's economy and social well-being.

I am also pleased that a fellow Pennsylvanian has joined us today, Mr. Gordon Hoover, a dairy farmer from Gap, PA. I want to welcome Mr. Hoover - who will be testifying on behalf of the National Milk Producers Federation - and thank him for participating in this discussion that should prove to be insightful and informative. Mr. Hoover's presence here today is an important reminder of Pennsylvania's strong standing in the agriculture community. Also joining us today is the senior Senator from Pennsylvania. I'm glad that Senator Specter could testify before the committee to further the dialogue that is so important to our constituents.

In the Commonwealth of Pennsylvania, agriculture is the number one industry. This may come as some surprise to those not familiar with our landscape, but the family farm - particularly the family *dairy* farm - is the agricultural heart of our Commonwealth. Income from dairy farming makes up the single largest component of agricultural income in Pennsylvania, and we rank fourth in national milk production contributing nearly seven percent of the national production total.

Many people in the agriculture community, and those associated with it, know that dairy farming is a particularly difficult business. Producers and their families work long hours with hardly a day off. And unlike other businesses, dairy producers must accept a price they are offered rather than setting a price for their goods. Volatility is a word that dairy farmers, unfortunately, know all too well. The recent price drop, to nearly $9.60 per cwt, is the lowest milk price producers have seen in more than twenty years leaving small dairy operators particularly vulnerable. In a world where consolidation and integration have become the order of the day, I believe we need to take a strong stand to preserve the backbone of our nation's agriculture community: the family farm. The lingering question is how do we achieve that goal.

I firmly believe that we need a multi-faceted and forward-looking approach to ensure that our dairy industry remains a vital part of our economy. Such a comprehensive plan needs to: (1) encourage growth in our export markets; (2) cut the production costs of farmers with a particular eye towards tax policy reform; (3) continue investment in agricultural research; (4) advocate the use of risk management tools by farmers to protect against market volatility; and (5) assist producers in preserving valuable farmland.

Along those lines, I strongly support the Dairy Export Incentive Program to level the playing field for our farmers. In terms of tax policy reform, I have long supported a reduction in the capital gains tax rate, and raising the estate tax exemption so that farmers have the opportunity to pass along their farms to their children. As for agricultural research, I was proud to have contributed to the development of the Agriculture Research Extension and Reform Act of 1998. Producers must have adequate tools to compete in the market place, and continuing research will enable all producers to share in the benefits through the work done by cooperative extension. In terms of risk management, I strongly advocate the use of risk management tools so that producers and processors can protect themselves against volatile feed costs and product prices. On that point, following passage of the 1996 farm bill, I pressed the USDA to establish a demonstration of the Dairy Options Pilot Program for Pennsylvania farmers. We are now in Round II of the program, and several counties in the Commonwealth participate. Another valuable risk management tool, Farm and Ranch Risk Management Accounts, would become available through Senator Grassley's legislation, S. 642. Finally, as the author of an amendment that created the federal program for farmland protection, I firmly believe that preserving valuable farmland is an important component of any dairy or agricultural policy reform.

These two days of hearings will be valuable in assessing the role of government in the dairy industry, and asking what has worked and where we have run afoul. We are at a time when comprehensive and thoughtful reform to our national dairy policy is much-needed, and long overdue. A continued piecemeal approach will only create more confusion and interruption in the market, and hamper the ability of our nation's producers to succeed.

Mr. Chairman, I appreciate the opportunity to share a few thoughts about the course of our dairy policy, and look forward to hearing from all of our witnesses. I stand ready to work with you and other interested colleagues to create a fairer and more stable environment for our nation's dairy community to ensure their continued prosperity and contribution to our economic and social well-being.

STATEMENT OF KEITH COLLINS
CHIEF ECONOMIST
U.S. DEPARTMENT OF AGRICULTURE
BEFORE
THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

February 8, 2000

Mr. Chairman and Members of the Committee, the Department of Agriculture appreciates your invitation to discuss the impact of dairy policy and programs on producers, consumers and Federal outlays. I will start with a brief overview of the economic situation in dairy markets. This description provides the context in which dairy policy will operate in the future. I will then review the performance of the major Federal programs operating today: the milk price support program, emergency market loss assistance programs, the Dairy Export Incentive Program (DEIP), the Federal milk marketing order program and dairy compacts.

The State of the Dairy Economy

Milk production. Over the past decade, milk production has increased by about 1.2 percent per year, as milk production per cow increased about 2.2 percent per year while milk cow numbers declined about 1 percent per year. Milk production is projected to increase 2.3 percent to 164.9 billion pounds during the current 1999/00 marketing year, which began on October 1. This would be the second largest percentage increase in milk production during the decade of the 1990's surpassed only by last year's 3 percent increase. In contrast, milk production rose just 0.4 percent during 1997/98. During the past two years, ample feed supplies, low feed prices, favorable weather in most areas of the country and strong milk prices until recently have supported the expansion in milk production. In response to these economic incentives, producers have reduced milk cow culling rates and increased the number of dairy replacements causing cow numbers to remain steady.

Milk production continues to shift regionally. California surpassed Wisconsin as the nation's top milk producing state in 1993. California now produces one-third more milk than Wisconsin. Milk production also is increasing rapidly in several other western States supported by an ample supply of good quality forage and a favorable weather. For example, Idaho currently ranks 6th in the nation in milk production behind California, Wisconsin, New York, Pennsylvania and Minnesota, compared with 12th just 10 years ago. Ten years ago, New Mexico was in the bottom one-half of all states in milk production and now it is in the top ten.

Milk Use. Commercial disappearance of dairy products increased 2 percent per year over the past 10 years led by a 3.5 percent per year increase in commercial disappearance of cheese. Commercial disappearance of butter registered gains of 4 percent per year from 1988-95, reversing the trend of the previous decade in which disappearance of butter stagnated amid consumer health concerns. From 1995-98, commercial disappearance of butter again stagnated, but still remains 25 percent above decade-earlier levels. Fluid milk consumption continues to grow slowly at less than 1 percent per year. Commercial disappearance of nonfat dry milk increased sharply in 1995 and 1996 but has since dropped 14 percent. In 1998, commercial disappearance of nonfat dry milk was up 18 percent, compared with 10 years ago.

In 1998/99, commercial disappearance of dairy products rose 2.6 percent, despite prices well above those for most of the 1990s, in large part due to continued strong U.S. economic growth. Continued favorable economic growth and steady-to-lower retail prices are expected to boost domestic dairy product sales by 3 percent this marketing year.

Prices. Farm-level milk prices were record-high in 1998/99 averaging $15.37 per cwt., up from the previous high of $14.60 per cwt. in 1997/98. Soaring milk production caused milk prices to collapse during the final months of 1999. In November and December, the Basic Formula Price (BFP) for manufacturing uses of milk fell to the lowest level in more than 21 years, as cheese prices fell to near the support price and nonfat dry milk prices were at support with the Commodity Credit Corporation (CCC) buying nonfat dry milk at a relatively high rate. For the 1999/00 marketing year, USDA predicts the all-milk price will average $12.45 per cwt., which would be the lowest all-milk price in 9 years. The decline in farm milk prices should start to trim growth in milk production by the second half of 2000 supporting a recovery in farm prices.

Retail dairy product prices rose 5.6 percent in 1999, reflecting strong farm-level milk prices. In 2000, weakening farm-level prices are forecast to lead to 1-2 percent decline in retail dairy product prices.

Financial condition of U.S. Dairy Farms. U.S. dairy farms improved their financial position in 1998 and 1999. Dairy concentrate expenses dropped 10 percent in 1998 and dropped further in 1999. The drop in feed costs combined with record-high milk prices caused returns over concentrate costs in 1998 and 1999 to be considerably above the average of the 1990's. Nationally, net cash returns, defined as gross revenue less cash expenses, increased from only $0.65 per cwt. of milk sold in 1997 to $3.42 per cwt. in 1998 and were likely near that level in 1999.

Using survey information, the Economic Research Service (ERS) estimates the net cash income of dairy farms with annual gross sales of $50,000 or more averaged $95,000 in 1998 and 1999, compared with the 1994-98 average of $64,800. In 2000, the net cash income of dairy farms is projected to fall by 21 percent to $74,900. Due to the strength of dairy farm balance sheets, the drop in income in 2000 is expected to lead to a small increase in the share of vulnerable dairy farms. The share of dairy farms considered financially vulnerable--negative farm income with debt-asset ratio exceeding 0.4--fell to 2.6 percent at the end of 1998, the lowest level in the 1990s. In comparison, nearly 5 percent of all farm businesses were considered to be financially vulnerable at the end of 1998. Eleven percent of dairy farms had debt repayment problems (debt equal to 120 percent or more of debt that can be repaid with current income) at the end of 1998, compared with 22 percent of all farm businesses. Declining milk prices are expected to increase the proportion of dairy farms with debt service problems to about 17 percent at the end of this year.

Despite the improvement in returns in 1998 and 1999, the number of dairy farms continued to decline as smaller dairy farms give way to fewer, larger operations. In 1999, the number of operations with milk cows as reported by the National Agricultural Statistics Service dropped 5 percent from 117,180 to 111,220. While the total number of dairy farms is declining, the number of large operations is increasing. In 1999, the number of dairy operations with fewer than 50 cows, over one-half of all dairy farms, dropped by over 8 percent. In contrast, the number of dairy operations with 500 or more cows, about 2 percent of all dairy farms, increased by more than 6 percent. There are no indications that the structural adjustment taking place in dairy farming will slow down anytime soon and appears largely unaffected by current dairy programs.

<u>Long term outlook.</u> Looking beyond the current marketing year, we expect trend growth in commercial use of dairy products to keep pace with increases in milk supplies. Milk cow numbers are expected to decline slowly, continuing a long-term trend. Nevertheless, milk

production is projected to grow about 1-2 percent per year as productivity gains and structural changes continue to increase efficiency.

The traditional centers of milk production appear to be in the early stages of the most dramatic structural changes in milk production since the adoption of bulk tanks. A new type of dairy farm appears to be emerging that is much larger, lowering capital costs per cow. This new dairy farm will use more purchased inputs, including labor, and have other characteristics similar to typical western dairy operations.

Farm milk prices are projected to remain under some pressure over the next couple of years, with the all-milk price averaging between $12.50-$13.00 per cwt. These subdued prices and higher feed costs are likely to lead to declining cow numbers, slowing the growth in milk production. Continued expansion in demand for dairy products should then lead to higher milk prices and improved returns. However, milk prices and returns will likely continue to remain quite volatile both from year-to-year and season-to-season.

Dairy Programs

The often-stated objectives of Federal dairy policy are not unlike those for agriculture in general and include assuring an adequate, safe supply of milk at reasonable cost to consumers; maintaining prosperity of producers; protecting the environment; ensuring program spending is cost-effective; promoting market orientation and competitiveness; and honoring international trade agreements. To address these objectives, the Federal government operates a number of interrelated programs. This section describes the major programs, including the milk price support program, the Dairy Export Incentive Program (DEIP), emergency market loss assistance programs and milk marketing orders. CCC outlays for the milk price support program, DEIP, and emergency assistance to dairy producers amounted to $480 million in FY 1999 and are expected to surpass $500 million in FY 2000.

Milk Price Support Program. The CCC administers the price support program by announcing purchase prices for butter, cheese and nonfat dry milk. These purchase prices are set by formula and established so that firms of average processing efficiency can pay producers the support price for milk. The formula takes into account the amount of each product produced from 100 pounds of milk and provides an allowance for the cost of converting milk into manufactured dairy products. Since butter and nonfat dry milk are joint products, increasing the purchase price of either product can be offset by an equivalent decrease in the other, leaving the milk price support level provided to producers unaffected. Tariff-rate quotas prevent imports from undermining the milk price support program.

Prior to late October 1981, the Agricultural Act of 1949, as amended (1949 Act), required that the support price for manufacturing milk be set at 75-90 percent of parity. Under this legislation, the support price for manufacturing milk rose steadily to $13.49 per cwt. in October 1981, leading to excessive surpluses of dairy products and record outlays under the price support program.

Amendments to the 1949 Act by the Agriculture and Food Act of 1981 were the first to relate the minimum support price for milk to the size of CCC purchases, severing adjustments in the support price to parity. Between October 1981 and October 1990, the support price for milk fell by over 25 percent to $10.10 per cwt. The support price remained at that level through December 31, 1995, before increasing to $10.35 per cwt. on January 1, 1996.

Also during the 1980's, Congress authorized two short-term voluntary supply management programs to help balance supply and demand for dairy products. The first of these programs, the Milk Diversion Program, paid producers $10 per cwt. for reducing their marketings by 5 to 30 percent. The second of these programs, the Dairy Termination Program, paid producers to liquidate their herds and remain out of milk production for 5 years. Both programs were opposed by livestock and consumer interests. In the short-term, these programs helped to reduce milk production, purchases under the price support program and government stockpiles of dairy products and boost prices to producers. In the long-term, producers responded to higher prices by expanding milk production. In order to help pay for these programs and to reduce the cost of the milk price support program, Congress also authorized producer assessments on milk marketings. These assessments peaked at $1.00 per cwt. in the early 1980s of which $0.50 was refundable to producers who had not expanded production.

The Federal Agriculture Improvement and Reform Act of 1996 amended the milk price support provisions of the 1949 Act by setting the support price for milk at $10.35 per cwt. during 1996, with $0.15 per cwt. reductions annually through 1999 at which time authority for the price support program was to expire. In addition, no authority was provided for producer marketing assessments, which producer interests had strongly opposed. Last year, Congress extended the price support program through December 31, 2000, with the support level set at $9.90 per cwt. Under current legislation, the milk price support program is to be replaced by a processor recourse loan program for dairy products at the equivalent of $9.90 per cwt. on January 1, 2001. The President's Budget request for FY 2001 proposes extension of the milk price support program through 2002, at which time the current farm bill expires.

During the early 1980s, the cost of milk price support escalated rapidly reaching a record

$2.5 billion in FY 1983. Reductions in the level of support, producer marketing assessments and other program changes reduced the cost of the price support program over the next several years. By FY 1995, the price support program had a net budget inflow of $164 million, as producer marketing assessments exceeded government dairy product purchase costs. Over the past three years, increasing milk production, the elimination of producer marketing assessments and weak demand for nonfat solids have caused the cost of purchases under the milk price support program to rise steadily, reaching $183 million in FY 1999.

The CCC purchased 172 million pounds of nonfat dry milk in FY 1999, up from 121 million pounds the previous year. From October 1, 1999 through February 4, 2000, the CCC has purchased 100 million pounds of nonfat dry milk, compared with about 2 million pounds over the same period last year. Increased purchases of nonfat dry milk could push the cost of the price support program to over $350 million in FY 2000, the highest level in nearly a decade. USDA has not purchased any butter or cheese under the price support program in several years, but cheese prices are currently near support.

The milk price support program has performed with fewer problems during the 1990s than during the 1980s. The burdensome dairy stockpiles that were once headlines are gone. With the exception of nonfat dry milk, purchases have not been excessive. While program costs are on the rise, they are well below the peak set in the mid-1980s and not out of balance with respect to other commodities. In FY 1999, the milk price support program accounted for less than 1 percent of total CCC outlays, compared with over 13 percent in FY 1983.

As the support price for milk has declined, manufacturing milk prices increasingly have been above support and farm milk prices have become more volatile both from year-to-year and from season-to-season. During 1980-88, the price of manufacturing milk followed the support price, but by the late 1980s the price of manufacturing milk had moved considerably above support. During the 1990s, the manufacturing milk price averaged more than $2 per cwt. above the support price, and this marketing year USDA projects the manufacturing milk price will average about $0.55 above support. This suggests that the price support level is not providing a large incentive for producers to expand milk production. Alternatively, because the price support program is not providing much downside price support, it could be argued that the program is not very effective in reducing the extremely volatile milk prices in recent years faced by farmers, processors and consumers, and therefore is not very effective as a farm safety net program. Nevertheless, given the current and rising surplus of nonfat dry milk, terminating the price support program at the end of this year could prove disruptive to dairy producers and processors.

The effects of termination of the milk price support program at the end of this year depend on the amount of nonfat dry, and possibly other dairy products CCC would end up buying, if the price support program is continued beyond the end of this year. Assuming the growth in milk production moderates and nonfat dry milk purchases decline to near this past year's level in 2001, elimination of the price support program could lower the average price of nonfat dry milk by $0.10-$0.15 per pound and the national average all-milk price by $0.35-$0.55 per cwt., or 3 to 5 percent in 2001. Under these assumptions, dairy producers' incomes would fall by about $750 million. Likewise, consumer expenditures on dairy products would decline by about $750 million, while taxpayer costs would fall by about $200 million, excluding the cost of storage and disposition. If the disposition of CCC purchases displaces commercial sales, discontinuation of the price support program would result in a smaller drop in producer incomes and consumer expenditures. The drop in milk prices could be more severe in areas of the country where nonfat dry milk production is most heavily concentrated, such as the west and northeast.

Emergency Marketing Loss Assistance. In 1998, Congress appropriated $200 million for direct payments to dairy producers and authorized an additional $125 million in direct payments in 1999. To provide meaningful assistance to small and medium-sized dairy producers, USDA limited payments to each operation's first 26,000 hundredweight of milk production. This limit on eligible production caps payments on farms having approximately 150 or more cows, about 13 percent of all farms in 1999. All dairy farmers who produced milk during the last quarter of calendar year 1998 were eligible to sign up to receive payments, and each operation could elect to receive payments on either 1997 or 1998 milk production.

The sign-up period for the initial $200 million in payments ran from April 12 to May 12, 1999, and these payments were disbursed to producers in June 1999. The payment rate was $0.225 per cwt. and the maximum payment was about $5,845. Sign-up for the $125 million in payments began on January 24 and continues through February 28, and the payments are expected to be paid out in late March and early April. These additional payments are being distributed using the same production criteria as the initial payments--payments on the first 26,000 cwt. of production and on either 1997 or 1998 production. Farmers who received payments last June do not need to reapply for assistance. Only those eligible producers who did not participate in the previous program need to sign up. Based on the results from the previous sign-up, the payment rate on the $125 million in payments should turn out to be about $0.14 per cwt. with a maximum payment of about $3,650. These emergency payments provide modest short-term relief to dairy producers and for the most part are a direct transfer from taxpayers to producers, with negligible effects on consumers of dairy products.

Dairy Export Incentive Program. The DEIP is an export subsidy program similar to the Export Enhancement Program for other U.S. agricultural commodities. The program is used to assist U.S. dairy products to meet competition from subsidizing countries, especially the European Union, in targeted markets. Products exported under DEIP include milk powders, butterfat and several cheese varieties.

The DEIP provides cash bonuses to approved exporters based on bids submitted for specific products and markets. The DEIP bonuses are based on the difference between U.S. and world prices. For example, in FY 1999, the average bonus was $1,043 per metric ton for nonfat dry milk, $940 per ton for butter/butteroil, and $1,548 for cheddar cheese. In past years, bonuses have been as low as $528 for nonfat dry milk, $475 for butter, and $788 for cheddar cheese, reflecting higher world prices. Practically all U.S. butter and nonfat dry milk exports are made under the DEIP, whereas the DEIP is much less significant for cheese exports. Total DEIP spending was about $127 million in FY 1999.

Use of the DEIP is governed by the World Trade Organization (WTO) rules on export subsidies. WTO members agreed to reduce exports subsidies 21 percent by volume and 36 percent in value over a 6-year implementation period, which ends next year. In the first 2 years of the implementation period, the use of DEIP for nonfat dry milk was well below the WTO limits, but DEIP subsidies in the past 3 years, including expected use for this year, have exceeded the annual WTO limits. The United States has used the flexibility provisions in the WTO to exceed the annual limits, but in order to be in compliance at the end of the implementation period, allowable DEIP subsidies for 2000/01 (July - June) will be available for only 68,000 metric tons of nonfat dry milk. That volume represents a 33-percent drop from 1999/00's forecast level of DEIP-assisted exports of about 100,000 tons.

DEIP exports increase producer milk prices, consumer expenditures and taxpayer costs. If we assume 68,000 metric tons of nonfat dry milk exported under DEIP at a subsidy level of $1,050 per ton and elimination of the milk price support program, no DEIP exports would lower the price of nonfat dry milk by about $0.10 per pound and the all-milk price by about $0.35 per cwt. Under these assumptions, dairy producers' incomes would fall by about $575 million. Likewise, consumer expenditures on dairy products would decline by about $575 million, while taxpayer costs would fall by $71 million. As with elimination of the price support program, the drop in milk prices could be more severe in areas of the country where nonfat dry milk production is most heavily concentrated, such as the west and northeast.

Federal Milk Marketing Orders. Federal milk marketing orders are authorized by the Agricultural Marketing Agreement Act of 1937. Producers located in an area of the country decide by a two-thirds vote whether their milk marketings should be regulated by a Federal order. Federal orders regulate about 70 percent of the milk marketed in the United States. Milk marketings in California, which accounts for nearly one-fifth of milk marketings nationally, are regulated by a State order. The 1996 Farm Bill required the Secretary to reduce the number of Federal milk orders to 10 to 14. On January 1, 2000, the number of Federal milk marketing orders was reduced from 31 to 11 and other significant changes were instituted at that time.

Each Federal order specifies the minimum price that handlers must pay for milk. These minimum prices vary depending on how the milk is used. Class I milk is milk used in fluid milk products. Class II milk is used in fluid cream products, other food products and in perishable manufactured products such as ice cream, cottage cheese and yogurt. Class III milk is used in the production of hard cheeses, and Class IV milk is milk used in the production of butter and dry milk products. Class I milk receives the highest price and the minimum price for Class I milk varies by location. The minimum prices for Class II, III and IV milk are uniform across all orders. The prices of all classes of milk vary from month-to-month depending on supply and demand conditions for milk and dairy products. Revenues from all milk sales in each order are "pooled" together and each producer receives a minimum average or "blend" price adjusted for location.

Under the reforms implemented on January 1, 2000, the minimum Class I price equals the Class I price location differential plus the higher of an advanced Class III or Class IV value (new Class I mover). The minimum Class II price equals the Class IV price plus $0.70 per cwt. The Class III price is based on a product price formula that includes the prices of butter, cheese and dry whey. The Class IV price is based on a product price formula that includes the prices of butter and nonfat dry milk. The product prices used to calculate the Class III and IV prices are reported by National Agricultural Statistics Service (NASS) in its weekly Dairy Products Prices report. Prior to implementation of the Federal order reform, the minimum Class I price equaled the Class I price location differential plus the Class III price lagged two months (old Class I mover), the minimum Class II price equaled the Class III price lagged two months plus $0.30 per cwt. The Class III price equaled the BFP, which was determined by a survey of prices paid for milk by Grade B manufacturing plants in the Upper Midwest updated to the current month using a product price formula. The new Class IV price replaced the previous Class III-A price, which was also determined by a product price formula.

Some have been concerned that the new classified pricing structure will lead to lower prices to some producers, and Congress passed legislation last year requiring the Department to conduct hearings on the new Class III and Class IV pricing formulas. Beginning in September 1998 when the Department began publishing all of the data required to calculate the new Class prices, the BFP and the new Class III price formula both have averaged $13.41 per cwt. The new Class IV price averaged $13.32 per cwt., $0.07 per cwt. higher than the previous Class III-A price over the 16-month period, and the new Class I price mover averaged $0.60 per cwt. higher than the old Class I price mover from October 1998 through February 2000. The new minimum Class II price averaged $0.49 lower than the old minimum Class II price from October 1998 through January 1998. Across all Federal orders, had the new pricing structure been in effect since September 1998 the average producer blend price would have been about $0.20 per cwt. higher than under the pricing structure that was in place prior to January 1, 2000.

Several economic studies have shown that Federal order Class I differentials in some areas have been higher than necessary to attract fluid milk from supply areas, thereby enhancing producer incomes by raising the price producers would otherwise receive, and the price consumers would otherwise pay for milk used in Class I products (see Siebert, Stephenson and Anderson, Choices Magazine, 1997). These higher than necessary prices for milk used in Class I products lead to higher milk production and reduced consumption of fluid milk products. This results in increased supplies of milk available for the production of manufactured dairy products, lowering the price producers receive for milk used in the production of manufactured dairy products and the price consumers pay for butter, cheese and other manufactured dairy products. The extent to which a producer's average blend price is increased varies depending on the amount of milk used in Class I products, the size of the Class I differential and other supply and demand factors.

Economic studies suggest that national farm-level milk prices would decline by 1-3 percent in the absence of Federal orders, with farm income declining by $200-$500 million and consumer expenditures on dairy products falling by a similar amount. However, producers in markets with above average Class I utilization would see larger declines in their milk prices, while some producers in markets with below average Class I utilization could see their milk prices increase in the absence of Federal orders. Studies indicate that milk prices would fall more than the national average in the southeast, southwest and northeast, while increasing in the upper midwest.

Under the Secretary's Final Decision, which was overturned by Congress, the Secretary chose to lower Class I location differentials in some areas where supplies of milk for fluid use can be attracted at lower cost. Class I location differentials were increased in the upper midwest to better reflect the costs of attracting milk from manufacturing plants and of hauling milk from where it is produced to where it is needed at processing plants for fluid use. The average Class I location differential would have been reduced by about $0.29 per cwt., from the pre-reform average of $2.57 per cwt. As noted above, had this decision been in effect over the past 17 months, this $0.29 average decline in the location differential would have been more than offset by the new and higher Class I price mover.

Dairy Compacts

Congress passed legislation last year that extended congressional consent for the Northeast Interstate Dairy Compact (the Northeast Compact), which was due to expire with implementation of Federal order reform, through September 30, 2001. The Northeast Compact currently includes Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont. Maryland, New Jersey, New York, Delaware, Pennsylvania and Ohio can also join the Northeast Compact if the joining State is contiguous to one or more Northeast Compact States and upon approval of Congress.

Legislation was also introduced in Congress last year to provide congressional consent for a southern dairy compact consisting of up to sixteen states--Alabama, Arkansas, Florida, Georgia, Kansas, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia and West Virginia.

The economic effects of the current Northeast Compact and extending it to other States have been examined in several studies. The Agriculture Appropriations Act for FY 1998 directed the Office of Management and Budget (OMB) to conduct a study of the Northeast Compact. The OMB examined its effects over the period from July 1 to December 31, 1997. In January 1999, two University of Missouri researchers published a study that examines the economic implications of expanding the number of States covered by dairy compacts. In November 1999, several University of Vermont and University of Massachusetts researchers published a study of the effects of the Northeast Compact from July 1997-June 1998. These studies indicate that compacts have a range of economic effects.

For producers serving the regulated area, compact regulation raises the effective farm milk price and producer incomes by increasing the price handlers must pay for milk used in fluid products. The Missouri study indicates that a $2 per cwt. over-order compact price would raise the all-milk price by nearly $1 per cwt. in the Southeast. Dairy farmers react to higher prices by expanding their dairy herds and increasing feeding rates, both of which lead to higher milk production.

The studies indicate higher prices for fluid milk are fully passed on to consumers. The University of Missouri study indicates that a $2 per cwt. compact over-order price would increase the retail price of fluid milk by about $0.15-$0.31 per gallon depending on assumptions for the farm-to-retail price markup. Consumers react to the higher retail price for fluid milk by reducing fluid milk consumption.

Higher milk prices due to compact regulation raise milk production and lower fluid milk consumption in compact States, which results in more milk available for processing into manufactured dairy products, such as cheese, butter and nonfat dry milk, reducing prices for these products and farm milk prices to producers in non-compact States. The OMB study estimated that the average all-milk price outside the Northeast Compact was reduced by $0.02 per cwt. during July-December 1997. The Missouri study suggests that a combined northeast, southeast, and mid-Atlantic compact would reduce the all-milk price to producers in other areas of the country by $0.17-$0.23 per cwt.

Mr. Chairman, that completes my review of the current market situation for milk and the performance of the principal Federal dairy programs. I note that the programs reviewed here are supplemented by many other Federal programs that affect milk producers and the dairy market, including risk management programs, food assistance programs, trade programs other than DEIP, promotion programs and research and extension programs. I would be pleased to respond to questions.

U.S. Milk Supply, Use and Prices

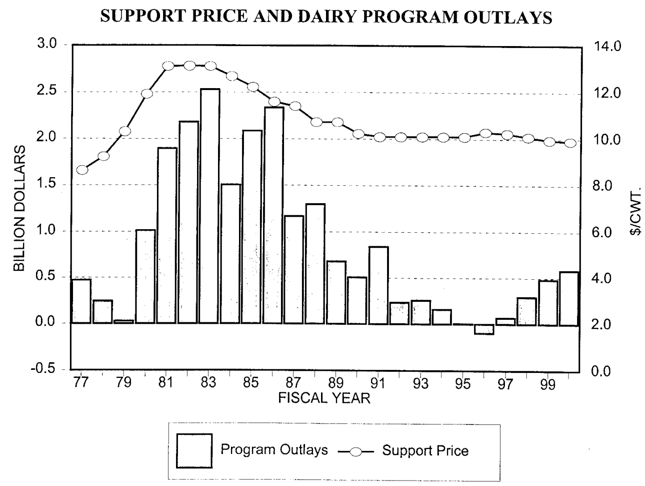
Commodity	1996/97 1/	1997/98 1/	1998/99 Est 1/ Dec	1998/99 Est 1/ Jan	1999/00 Proj 1/ Dec	1999/00 Proj 1/ Jan
MILK			Billion pounds			
Supply						
Beg. commercial stocks 2/	4.9	5.9	5.8	5.8	7.5	7.5
Production	155.9	156.5	161.2	161.2	164.4	164.9
Farm use	1.4	1.4	1.3	1.3	1.3	1.3
Marketings	154.5	155.2	159.9	159.9	163.1	163.6
Imports 2/	2.8	4.0	4.8	4.8	3.7	4.2
Total cml. supply 2/	162.3	165.1	170.5	170.5	174.3	175.2
Use						
Commercial use 2/ 3/	155.6	158.6	162.8	162.8	167.1	167.8
Ending commercial stks. 2/	5.9	5.8	7.5	7.5	6.6	6.8
CCC net removals:						
Milkfat basis 4/	0.7	0.7	0.3	0.3	0.5	0.6
Skim-solids basis 4/	2.7	4.5	5.4	5.4	4.2	6.5
			Dollars per cwt			
Milk Prices						
Basic Formula/Class III /5	11.88	13.28	14.04	14.04	10.40-11.00	10.20-10.70
All milk 6/	13.53	14.60	15.37	15.37	12.25-12.85	12.20-12.70
			Million pounds			
CCC product net removals 4/						
Butter	24	21	1	1	15	15
Cheese	10	8	6	6	6	6
Nonfat dry milk	222	368	449	449	350	545
Dry whole milk	7	15	12	12	12	12

Note: Totals may not add due to rounding.
1/ Marketing year beginning October 1. 2/ Milk equivalent, milkfat basis.
3/ Includes commercial exports. 4/ Includes products exported under the Dairy Export Incentive Program. 5/ Basic Formula Price through Dec. 31, 1999; Class III price beginning Jan. 1, 2000 6/ Milk of average fat test. Does not reflect any deductions from producers as authorized by legislation.

U.S. dairy situation at a glance

	Unit	1997	1998	1999
Milk production:				
Production (20 States)	Mil. lb.	133,314	134,930	139,999
Milk cow (20 States)	Thou.	7,760	7,710	92,785
Milk per cow (20 States)	Lb.	17,180	17,501	18,104
Production (U.S. est.)	Mil. lb.	156,091	157,441	162,732
Milk prices:				
All milk	Dol./cwt	13.34	15.43	14.38
Milk eligible for fluid use	Dol./cwt	13.38	15.47	14.43
Manufacturing grade milk	Dol./cwt	12.18	14.33	12.76
Basic Formula Price (3.5% fat)	Dol./cwt	12.05	14.20	12.43
Slaughter cow price, WI	Dol./cwt	36.93	35.54	37.28
Wholesale prices:				
Butter, Central States 1/	Ct/lb	116.2	177.6	125.0
American cheese, WI assembly pt.				
40-pound blocks	Ct/lb	132.4	158.1	142.3
Barrels	Ct/lb	125.2	151.7	136.4
Nonfat dry milk, Central States	Ct/lb	110.0	106.9	103.5
Retail prices:				
Consumer Price Index	1982-84=100	160.5	163.0	166.6
All food	1982-84=100	157.3	160.7	164.1
Dairy products	1982-84=100	145.5	150.8	159.6
Fluid milk	Dec 1997=100	NA	101.3	107.6
Other dairy products	Dec 1997=100	NA	101.9	107.2
Dairy product output:				
Butter	Mil. lb	1,151.3	1,081.9	NA
American cheese	Mil. lb	3,285.6	3,325.8	NA
Other-than-American cheese	Mil. lb	4,044.9	4,176.1	NA
Frozen products 2/	Mil. gal.	1,290.0	1,325.9	NA
All products (m.e.-fat)	Mil. lb	96,323	96,585	NA
Nonfat dry milk	Mil. lb	1,217.6	1,135.4	NA
Beginning stocks:				
Commercial butter	Mil. lb	13.4	20.5	25.9
Commercial American cheese	Mil. lb	379.6	410.3	407.6
Other cheese	Mil. lb	107.3	70.0	109.5
Manufacturers' nonfat dry milk	Mil. lb	71.1	103.3	56.3
All commercial (m.e.-fat)	Mil. lb	4,704	4,889	5,274
All commercial (m.e.-skim)	Mil. lb	5,753	6,080	5,905
All Government (m.e.-fat)	Mil. lb	10	18	28
All Government (m.e.-skim)	Mil. lb	7	258	1,115
Commercial disappearance:				
Butter	Mil. lb	1,109	1,137	NA
American cheese	Mil. lb	3,269	3,350	NA
Other-than-American cheese	Mil. lb	4,367	4,450	NA
Nonfat dry milk	Mil. lb	894	867	NA
All products:				
m.e.-fat	Mil. lb	156,118	159,917	NA
Milkfat	Mil. lb	5,722	5,847	NA
Skim solids	Mil. lb	13,327	13,510	NA
USDA net removals:				
Butter	Mil. lb	38.4	6.3	3.7
Cheese	Mil. lb	11.3	8.2	4.5
Nonfat dry milk	Mil. lb	298.0	326.4	536.3
All products (m.e.-fat)	Mil. lb	1,090	366	337
All products (m.e.-skim)	Mil. lb	3,681	3,974	6,400
Imports				
All products (m.e.-fat)	Mil. lb	2,698	4,588	NA
All products (m.e.-skim)	Mil. lb	3,165	3,746	NA
International market prices:				
Butter	$/metric ton	1,861	1,908	1,506
Nonfat dry milk	$/metric ton	1,738	1,440	1,332

1/ Grade AA Chicago before June 1998. 2/ Hard ice cream, ice milk, and sherbert.
m.e.-fat (skim) = Milk equivalent, fat (skim solids) basis


SUPPORT PRICE AND DAIRY PROGRAM OUTLAYS
BILLION DOLLARS
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
$/CWT.
14.0
12.0
10.0
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77
79
81
83
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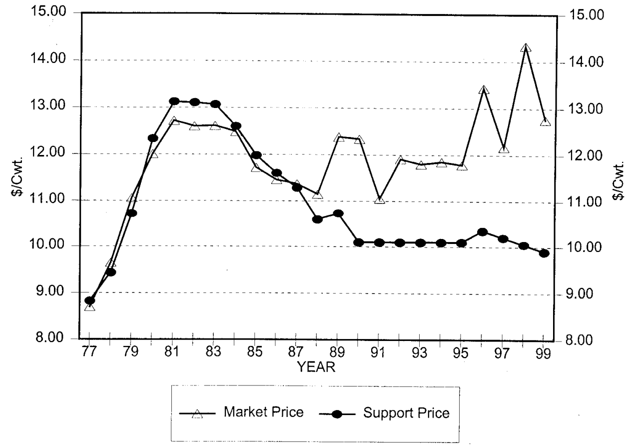
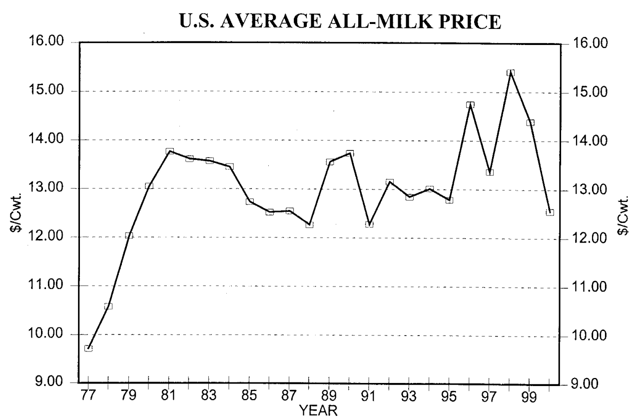
FISCAL YEAR
Program Outlays
Support Price

PRICE AND SUPPORT LEVEL FOR MANUFACTURING MILK




U.S. AVERAGE ALL-MILK PRICE
16.00
15.00
14.00
13.00
12.00
11.00
10.00
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$/Cwt.
77
79
81
83
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89
91
93
95
97
99
YEAR

COMPARISON OF CURRENT AND FINAL DECISION CLASS PRICES

	Final Decision			
	Class III Price	Class IV Price	Class II Price	Class I Price Mover
1998:				
Sept.	14.66	18.71	N/A	N/A
Oct.	16.05	18.19	18.67	18.32
Nov.	16.90	15.71	16.39	18.06
Dec.	17.51	13.39	13.98	16.82
1999:				
Jan.	15.85	13.45	14.31	17.44
Feb.	11.35	12.71	13.72	16.90
Mar.	11.51	12.56	13.47	12.74
Apr.	11.64	11.26	12.05	12.75
May	10.91	11.53	12.21	11.67
June	11.04	13.14	13.84	11.16
July	12.92	12.79	13.50	13.04
Aug.	15.61	12.77	13.46	12.88
Sept.	15.60	12.67	13.29	15.26
Oct.	12.48	11.83	12.50	16.54
Nov.	10.57	11.54	12.26	12.90
Dec.	9.91	10.87	11.64	11.59
2000:				
Jan.	--	--	11.43	10.90
Feb.	N/A	N/A	N/A	10.71
Monthly Ave.	13.41	13.32	13.55	14.10

	Actual			
	BFP	Class III-A Price	Class II Price	Class I Price Mover
1998:				
Sept.	15.10	19.81	--	--
Oct.	16.04	18.13	15.29	14.99
Nov.	16.84	14.87	15.40	15.10
Dec.	17.34	13.48	16.34	16.04
1999:				
Jan.	16.27	13.12	17.14	16.84
Feb.	10.27	12.78	17.64	17.34
Mar.	11.62	12.36	16.57	16.27
Apr.	11.81	11.06	10.57	10.27
May	11.26	11.62	11.92	11.62
June	11.42	13.29	12.11	11.81
July	13.59	12.37	11.56	11.26
Aug.	15.79	12.62	11.72	11.42
Sept.	16.26	12.37	13.89	13.59
Oct.	11.49	11.78	16.09	15.79
Nov.	9.79	11.57	16.56	16.26
Dec.	9.63	10.69	11.79	11.49
2000:				
Jan.	N/A	N/A	10.09	9.79
Feb.	N/A	N/A	--	9.63
Monthly Ave.	13.41	13.25	14.04	13.50

**NASS began publishing data on prices for dairy products needed to compute class prices under Usda's final decision in October 1998 which included data for September.

--Indicates data available but excluded from table because comparable actual data not available.

Senator Patrick Leahy
February 8, 2000

Mr. Chairman, one thing that is great about dairy policy is that it brings people together. It brought all of us together this morning. It also makes some unusual partnerships. For instance I would guess that one of the few things that Hillary Clinton and Rudy Giuliani agree on at this point in their campaign is the Northeast Dairy Compact. They are both for it.

Mr. Chairman, I do thank you and want to leaven our discussion with a little levity. But before I start, I want to say that dairy policy is a serious topic – it represents a way a life for farm families throughout America.

I do not want dairy farmers in Minnesota, Wisconsin, Mississippi, Iowa, North Carolina, Vermont, or anywhere else to go out of business because of failed dairy policies or a stacked deck.

I say this to everyone: I will support, and vote for, reasonable legislation that helps dairy farmers in the Upper Midwest, in the South, in California, or elsewhere to get a fair price for their labor. I will work with any region of the country.

Back in my office I have a tall stack of the floor speeches and industry diatribes that have been leveled against the Northeast Dairy Compact. Scores of charges were made before the Compact legislation was passed the first time. They were wrong, and the Compact has gone on to do just what we said it would do. To help the committee along I summarized the top ten of these myths and indicated what the real facts are. I do not want to be harsh in characterizing these charges, so I have used some euphemistic language in my heading. My staff claims that's a real word. I hope for their sake they are right. Let's just say that some unfair things have been said about the Compact.

Number Ten is the claim I have heard some make, that the Northeast Dairy Compact erects a barrier to milk just like the Great Wall of China. Actually, the Compact law mandates that all milk must be allowed to be sold into the region.

The reason that Mrs. Clinton and Mayor Guiliani support the compact is that it has been great for farmers living near the Compact region, since they can sell into the region and gain its benefits. Over one-quarter of Compact benefits have been paid to New York State dairy farmers.
In terms of allegation 9, I have to disagree with those who think the Compact is more " terrifying than the Blair Witch Project." I certainly know it does not add "50 cents to $1 to the price of a gallon of milk."

A 1998 GAO report noted that milk prices in Minnesota and Wisconsin were much higher than prices in the Northeast.

For example, on February, 1998, the average price of a gallon of whole milk in Augusta, Maine was \$2.47. The price for Milwaukee was \$2.63 a gallon. Prices in Minneapolis were \$2.94/gallon. In Boston the price of a gallon was \$2.54. I could go on and on. I will just give you one more example.

The cost of 1 percent milk for November, 1997, in Augusta, Maine was \$2.37 a gallon, the same average price as for Boston and for New Hampshire and Rhode Island. In Minnesota, the price was \$2.82.

Number 8 is the claim that the Compact is like a "milk tax." Well, if Compact prices represent a "milk tax" then other states outside New England have higher milk taxes because they have higher prices.

This allegation is ironic – according to OMB, a special WIC reimbursement program actually gets *extra* funding from the Compact Commission to put *additional* eligible women, infants and children on the WIC program at no cost to taxpayers.

The allegation suggests a serious problem that we might be able to solve. The school lunch program is being ripped off in some non-Compact states. School contracts often establish a *fixed* price for an entire school year for milk purchases. So when there is a drop in the cost of milk to processors, those processors can make a killing on their year-long school lunch contracts since they make windfall profits as they pay farmers less for milk.

We could introduce legislation to recoup these windfall profits and put the money back into the school lunch program.

Allegation 7 asserts that the [The Compact] "does have dramatic effects and impacts upon prices of farmers in other areas, especially in the Upper Midwest."

The OMB report says that is not the case. However, the reverse is certainly true – the Upper Midwest with many times the farmers as New England certainly has a major impact in the South and the Midwest.

I have read many statements in newspapers and in the Congressional Record that the Upper Midwest wants to produce milk for the entire nation using new technologies such as rehydration or reconstituting milk. The only problem for the Upper Midwest is that Southern farmers, Mid-Atlantic and Western farmers are in the way. All of these farmers want to stay in business and provide fresh, local supplies of milk to their communities. Also in the way are consumers, who for some reason do not seem ready to develop a taste for reconstituted milk.

Allegation 6 raises a similar point, that New England's success depresses the nonfluid prices nationwide.

Generally speaking, production in New England addresses its own needs. Yet, milk is so overproduced in Minnesota and Wisconsin that 85 percent of it goes into manufactured products such as cheese which we find for sale throughout New England, the South and other regions.

Regarding allegation 5, I was surprised that some think that the Secretary of Agriculture opposes the Compact. That would be news to me, and to Secretary Glickman. The Secretary found that the Compact was in the compelling public interest on the region after holding a rulemaking and receiving comments from the Upper Midwest.

Allegation 4 is that the Compact helps large farms more than it helps small farms.

There is a kernel of truth to this. Like most farm safety net programs, benefits are determined by the volume of your past production or your "base." Thus, just as farmers with more cows in the Upper Midwest usually make more than farmers with fewer cows – it is also the case that New England farmers with more cows get more Compact benefits since they are paid on a hundredweight basis.

However, there should be some limits. The Compact Commission is looking at imposing some type of limit, similar to payment limitations, that would prohibit these safety-net benefits beyond a certain level of production. They also could simply not provide the safety-net benefit for any increases in milk production above a certain base. I think these limits would be a good idea and would act to limit any potential increases in production.

Allegation Number is that "With higher prices, consumption goes down, and children are the biggest losers." This also suffers from a fatal flaw. Since milk prices in the Compact region are considerably lower during many months than in Wisconsin or Minnesota consumption of milk should remain strong in New England. And it has.

But I need to make another point. The safety net provided by the Compact helps protect our local supplies of fresh milk. I do not want prices to skyrocket every time there is a snow storm or ice storm anywhere from the Upper Midwest to Maine. At $5, or more, a gallon, consumption would indeed go down if parents in New Hampshire could not find milk for their children because of an ice storm in Ohio.

Allegation 2 says that the Compact does not help smaller farms. For small farms the Compact can make the difference between staying in business and going bankrupt. The larger farms can better withstand downturns without a Compact – but smaller ones cannot.

The Farm Bureau Federation reports significantly below-average losses of farms in New England with some Compact states reporting slight *increases* in the number of farms.

Allegation 1 came up during the competing ice cream socials we had last summer. The IDFA has its social, and Ben & Jerry's Vermont's Finest Ice Cream had their social. I think ours out-drew theirs, by the way. In any event it certainly was more fun.

One Senator suggested that the Northeast Senators "should give away cow manure instead."

I passed that suggestion onto Ben. They don't have high hopes for it, but "Phish Food" and "Chunky Monkey" worked.

Mr. Chairman, I want to stress again that there must be some solution to this dairy situation that works for all regions of the country. There are some special challenges different from many other farm products. Milk is very perishable – you can't just store it for four months to get a better price. Dairy farmers can't just switch from dairy to soybeans, one year, and then back to dairy the next. Dairy is also very labor intensive. I also do not think that most consumers will want reconstituted milk -- where you add water later.

Also, milk is not covered by Freedom to Farm payments and the milk price support program ends soon. And, Northern states face around 300 percent tariffs if we try to sell fluid milk into Canada. But, politics is the art of making the impossible, possible. I am ready to get to work.

I want to respond to many negative comments have been made about the Northeast Interstate Dairy Compact.

For example, Senator Feingold stated that "Over 96% of [the dairy farmers] voted in favor of USDA's final ruling [on modified Option 1B, milk marketing order reform]." (Con. Rec. S11238 - 9/22/99) That is correct. However, dairy farmers were not give a fair choice. They were forced to choose between Option 1B or no milk marketing orders. Many were forced to vote for a bad option.

I heard from many farmers who were very upset that they could not choose between the two options: Option 1-A versus the modified Option 1-B approach. Had they been able to do so, Option 1-A would have easily won.

Of the comments that USDA received on its order reform proposals, more than 3,500 were in support of Option 1-A, and less than 500 were in support of Option 1B. At an eight to one ratio, people demonstrated their support for Option 1-A.. Option 1-A has the support of groups including the National Farmers Union, the American Farm Bureau, the National Milk Farmers Association and the National Grange.

Last March, the USDA published its final decision for milk marketing order reform. This decision included a reform of the Class I, or fluid (drinking) milk, pricing system. Instead of strengthening the marketing order system, the Department's decision -- known as Option 1B -- would have reduced dairy farmer income in almost every region of the country by hundreds of millions of dollars every year.

Analyses by economists with the Agri-Mark Dairy Co-op estimate that dairy farmer income under the USDA's proposal would have decreased by about $500,000 to $1,000,000, per day, nationwide. Agri-Mark also estimates that New England farmers alone would have faced a $80 million to $120 million per year from this decision. (Bob Wellington, Agri-Mark Economist, April 8, 1999)

At a House Committee on Agriculture hearing this past fall, Mr. Jerome Kozak, CEO of the National Milk Producers Federation testified, that "NMPF has estimated, based on USDA's own data, that if we would have had this program [1B] in place during the past five years, dairy producers would have received nearly $1 billion less in revenue that they in fact received under the current system."

Some might point to the USDA's national referendum on the milk marketing reform as proof that farmers across America in fact supported the Department's Option 1-B, as it was approved by a vote of approximately 96% of those participating (USDA Agricultural Marketing Service). This statistic is incredibly misleading, however.
An August 6, 1999 letter from the Southeast Milk, Inc. states:

> Some are already asserting that an affirmative vote [for the Federal Milk Marketing Order reform] is an indication that producers can live with the final rule. We strongly disagree with that interpretation of our vote, and will vocally and repeatedly correct those who seek to put words in our mouths, or unfairly misconstrue the meaning of our vote. A vote in favor of the final rule is not enthusiastic support for it; it merely represents our even stronger fear that to vote against the flowed, problematic USDA final rule would mean we have no further recourse for fixing it.

Senator Feingold also said on the Senate floor that: "Even the person who approved them, the Secretary of Agriculture, now sees it was not a very good idea, and should be discontinued." (Con. Rec. S11240 - 9/22/99)

To my knowledge, Secretary Dan Glickman has never voiced opposition to the Dairy Compact - and instead has supported the authorization of the Compact because of his determination "of a compelling public interest in the Compact region." (Federal Register Vol. 61, No. 168, August 28, 1996 "Announcement of Implementation of the Northeast Interstate Dairy Compact")

Secretary Glickman also promised close oversight over the Compact to ensure that it does not have ". . . any adverse effects on the income of dairy producers outside the Compact region" or any negative impact on ". . .consumers, especially low-income families, within the Compact region," authority that has never been needed. (Federal Register Vol. 61, No. 168, August 28, 1996 "Announcement of Implementation of the Northeast Interstate Dairy Compact")

Also, a very temporary increase in milk prices has been criticized. For example, Senator Feingold quoted from an article: "Milk prices in new England rose about 20 cents a gallon after the compact went into effect in July 1997."

Senator Grams also said: "[After the compact was implemented] the price of milk in New England [rose] from $2.54 all the way up to a high of $3.21 a gallon." (Con. Rec. S12500 - 10/13/99)

However, In their report issued after the first six months of Compact operations, OMB reported that consumer prices in New England were _lower_, on average, than the rest of the nation. (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

According to statistics gathered by the International Association of Milk Control Agencies, the average retail price of milk for the months of February, March and April last year was $2.89 per gallon in Boston, Massachusetts, and was $2.92 per gallon in Augusta, Maine. Compare this with Seattle, Washington, where the average price per gallon was $3.44, or in Denver, Colorado, where the average price was $3.53 per gallon, or in San Diego, California, where the average price was $3.35. The New England prices are considerably lower than these other cities.

In its 1998 report, the General Accounting Office examined the retail price of milk in cities across the country. The report found that the average retail price of a gallon of 1% milk for November 1997 was $2.37 in Augusta, Maine; Boston, Massachusetts; New Hampshire and Rhode Island. The price in Minneapolis, Minnesota was $2.82. (October 1998 GAO report "Dairy Industry: Information on Prices for Fluid Milk and the Factors

That Influence Them")

The report found an average retail price of a gallon of whole milk in February 1998 also varied considerably – from $2.47 in Augusta, Maine to $2.63 in Milwaukee, Wisconsin to $2.94 in Minneapolis, Minnesota. (October 1998 GAO report "Dairy Industry: Information on Prices for Fluid Milk and the Factors That Influence Them")

The initial price increase just before the Compact was implemented is very suspicious. Note that beginning in November 1996, the price that farmers got for milk dropped by almost 25 percent -- 35 cents or so per gallon, and stayed low for months. Yet, store prices stayed high through July, 1997 -- which locked in huge profits. Note that the Northeast compact was implemented in July, 1997.

Even though stores had an additional margin of 35 cents per gallon built into their prices, some stores still increased prices to consumers when the Compact was implemented. Some lowered prices, and many stores kept prices the same. (1998 GAO Report "Dairy Industry: Information on Marketing Channels and Prices for Fluid Milk)

But, normal competitive forces took over quickly and OMB concluded that after six months retail store prices in the compact region of New England were *five cents lower* than the rest of the nation. (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

New England newspaper accounts of the implementation of the Compact include the July 1, 1997, the Portland Press Herald, Portland, Maine, which pointed out that "Cumberland Farms increased the price of whole milk by four cents but dropped the price of skim milk by a penny" when the Compact was implemented.

The June 30, Boston Globe reported that "The region's major supermarkets are raising their milk prices 20 cents a gallon, ignoring arguments that their profit margins [the 35-cent margin discussed above] are big enough to absorb a new price subsidy for New England dairy farmers that takes effect this week."

Some members have attacked the Compact as bad for low-income children. Of course, milk prices in Wisconsin and Minnesota are extremely bad for children.

Senator Grams said that "Low income families that need milk in their diet are not being reimbursed by the Compact for their increased costs. . . . this is a milk tax that hits low-income citizens hardest who spend a high percentage of their income on food." (Con. Rec. S10140 - 8/4/99)

He also said that the Compact "... is a milk tax" that hurts children. (Con. Rec. S14962 - 11/19/99)

Even a September 14, 1999 San Antonio Express-news editorial said: "[the Northeast Compact] helps large dairy farms more than small ones and adds from 50 cents to $1 to the price of a gallon on milk. This not only negatively impacts families, but also child nutrition programs." (Con. Rec. S14967 - 11/19/99)

The response is very simple: the Compact does not hurt WIC participants - it has actually provided additional funding for the WIC program, allowing more people to participate. High prices in Wisconsin and Minnesota might be a problem, but not the Compact.

The Compact was designed so that it reimburses WIC for any additional costs that it may incur because of the over-order premiums. The Office of Management and Budget reported that State WIC programs in New England *benefitted* under the Compact, as the Compact's reimbursement to WIC was greater than the losses it incurred. The OMB report stated:

> "Over the 6-month demonstration period, total WIC compensation is estimated to have exceeded the gross loss to the program due to higher milk prices..." (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")
>
> "Because compensation [to the WIC program by the Compact Commission] exceeded the assumed retail price increase, the Compact could support a small increase in participation during the demonstration period." (1998 OMB Report " The Economic Effects of the Northeast Interstate Dairy Compact")

In January 1998, the Compact Commission voted to exempt school lunch programs from the compact over-order price regulation. Like WIC, the school lunch and breakfast programs are also given reimbursements, and thus are not incurring any additional costs from the Compact's over order prices.

As of September 1999, reimbursements for WIC have totaled $2,000,000 and reimbursements to the School Food Service Authorities have totaled $183,000. (Northeast Dairy Compact Commission)

This leads to the bigger question. If dairy farms are forced to close because of low income, local, fresh sources of milk disappear. Instead of getting milk from the next town or a neighboring state, stores will have to start purchasing milk from farms thousands of miles away. Local milk should be cheaper to buy and shipments would not be subject to ice storms, snow storms, floods, or whatever.

Also, note that some argue that the school lunch program is being ripped off in some non-Compact states. School contracts often establish a *fixed* price for an entire school year for milk purchases. Thus, when there is a drop in the cost of milk to processors, processors can make a killing on their year-long school lunch contracts since they make windfall profits as they pay farmers less for milk. In Compact states the price drops are cushioned and thus processors are unable to make these huge windfall profits.

Another criticism is from Senator Grams: "[The Compact] promotes higher production and decreases prices outside the region." (Con. Rec. S10140 - 8/4/99)

Senator Feingold said that: "It would drive up production artificially in a way that would reduce prices for dairy farmers. I believe that is exactly what happened." (Con. Rec. S11240 - 9/22/99)

The response is that in its 1998 report on the Northeast Compact, the Office of Management and Budget (OMB) stated that in the first seven months of the Compact being in operation, there was only a slight increase - less than 0.5 percent - in milk production in New England, and "[this] estimated increase in milk production in New England due to the Compact was equivalent to 0.01 percent of U.S. milk production in 1997." (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

In an analysis entitled "Dairy Farmer Challenge USDA Compact Assessment" by Agri-Mark Co-operative Economist, Robert Wellington, it is stated:

> Since October 1, 1998, there have been 180 million pounds [of surplus powder] purchased, with 91% of that volume coming from Western states and the remaining 9% coming from the Midwest. Also, the Compact did not even make any payments to farmers for the first six months of USDA's fiscal year. During that period (October 1998-March 1999), milk production was up 3% nationally, but up only 2.4% in the Compact area. When Compact payments did begin in USDA's third quarter (April - June) after the record winter price decline, the milk production change in the New England States was even further below the national average – 1.3% in New England versus 3.0% nationally. This lower New England rate occurred despite the Compact's average $1.00 per cwt. monthly safety net payment to family farms during the spring.

The Compact's enabling legislation was written so that if there were any increases in production in New England which exceed the national rate, the federal government would be reimbursed -- by the Compact -- for any additional Commodity Credit Corporation purchases it makes. In addition, the text of the

Compact provides that the Compact Commission is to "take such action as necessary and feasible to ensure that the over-order price does not create an incentive for producers to generate additional supplies of milk" and that over-order pricing shall not "discriminate against milk producers outside the...area." (Compact, Article IV, Sections 9 and 10) The Commission is considering whether there is a need to take action to prevent the possibility of increases in production.

In 1998, for a variety of reasons milk production in New England increased at a faster rate than the national average, but mostly because the national rate dropped. Let me repeat that - New England was higher because the national rate dropped. In September 1998, the Compact paid the federal government $1.7 million for its increased purchases. (Northeast Dairy Compact Commission)

Yet, statistics from the CCC for 1997/1998 show that 90.2% of the surplus dairy products purchased by the CCC came *from the West*, and only .2% was purchased from the East coast. (Northeast Dairy Compact Commission)

New England states increased their milk production by 2% during the first three months of 1999 when compared to 1998. In contrast, however, the western states of California, Arizona, Idaho, Nebraska, New Mexico and Washington each increased by almost 1 billion pounds or about 8% each in the first three months of 1999. These western states' increase in milk production far exceeded New England's increase in production - and they don't belong to a compact. (Northeast Dairy Compact Commission)

New England dairy farmers did not increase the size of their herds so they could increase their income from the Compact's payments. In fact, comparing Vermont's milk cows and production from April of 1998 to April of 1999 shows that Vermont's milk production did increase slightly - by 2.6%. However, the number of cows *remained the same*. Farmers were not buying more cows and expanding their operations to take advantage of the Compact prices. (National Agricultural Statistics Service, USDA, "Milk Production, June 1999)

Another charge is that: "The Northeast Dairy Compact is heavily subsidizing large-scale dairy operations while those small farmers in the region do not receive enough to seriously impact their bottom line. (Senator Grams, Con. Rec S12500 - 10/13/99

The response is that, according to statistics from the USDA National Agricultural Statistics Service for 1998, there were 870 dairy farms with 50-100 cows in Vermont (32% of Vermont's farms); in Wisconsin, there were 8,400 (40%); Minnesota had 3,300 (38%). (January 28, 2000, National Agricultural Statistics Service, Agricultural Statistics Board, USDA)

Like most farm safety net programs, Compact benefits (over-order premiums) are determined by the volume of your production or your "base." Thus, just as farmers with more cows in the Upper Midwest usually make more than farmers with fewer cows – it is also the case that New England farmers with more cows get more Compact benefits since they are paid on a hundredweight basis. Of course, when milk prices for farmers are high no Compact benefits are paid. The Compact is a safety net program and thus only provides modest assistance to farmers when prices are low.

The Compact Commission is looking at imposing some type of limit, similar to payment limitations, that would prohibit these safety-net benefits beyond a certain level of production. They also could simply not provide the safety-net benefit for any increases in milk production above a certain base.

Senator Kohl has stated that "[Compacts] embody...disastrous implications for farmers who are forced to operate outside the protectionists walls these compacts throw up." (Con. Rec. S10140 - 8/4/99) Senator Grams has agreed by stating, "Don't erect artificial barriers that keep the products of the most efficient producers out of the hands of the consumers." (Con. Rec. S10140 - 8/4/99)

The response is that OMB reports that the Northeast Compact has *increased* interstate trade in fluid milk. (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

Dairy farmers fortunate enough to be living in states neighboring the Northeast compact region have increased milk sales into the compact area to gain the benefits of the higher compact price. OMB reported an 8 percent increase in trade -- increased sales of milk into the compact region from New York and other neighboring states to take advantage of the higher prices. (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

Of the approximate $77 million that has been paid out to farmers since implementation of the Compact, more than one-quarter ($23 million) has been paid to New York farmers. (Northeast Interstate Dairy Compact Commission)

Another criticism is from Senator Grams: "High quality milk can be trucked into New England at the peak of freshness and at less cost than it can be produced in most New England states." (Con. Rec. S14962 - 9/22/99)

He also said that "[The Compact] . . . does have dramatic effects and impacts upon prices of farmers in other areas, especially in the Upper Midwest."(Con. Rec. S12500 - 10/13/99)

However, the Northeast Dairy Compact has helped New England farmers -- but not at the expense of dairy farmers in other regions of the country. (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact") Looking at 1998 USDA statistics, farmers in the Upper Midwest actually made more for their milk than New England farmers did under the Dairy Compact. (April 1999 Dairy Market News, AMS, USDA)

In 1998, the average mail box price for milk in the upper Midwest was $15.27 per hundredweight, and the national average was $14.89. The average mail box price in New England was $14.89 -- which means that dairy farmers in New England received $.38 *less* per hundredweight than farmers in the Upper Midwest even with the Northeast Dairy Compact. (April 1999 Dairy Market News, AMS, USDA)

According to the Office of Management and Budget:

> "Net annual returns per cow, estimated using USDA's National Agricultural Statistical Service data on output per cow and the ERS [Economic Research Service] cost of production net returns, are about $490 in the United States as a whole, $350 per cow in Vermont, and $460 per cow in Wisconsin." (1998 OMB Report "The Economic Effects of the Northeast Interstate Dairy Compact")

Comparing milk production statistics for 1990, 1997 and 1998 (keeping in mind the Northeast Dairy Compact went into operation halfway through 1997, and was in operation through 1998) shows that Wisconsin has seen decreases in its per capita milk production - in the past nine years, Wisconsin's has decreased by 12.3%. However, comparing 1997 and 1998, when the Northeast Dairy Compact was in effect, Wisconsin had an increase in production of 1.7%. Clearly the Compact could not have been the cause of a drop in production in Wisconsin when production actually increased in Wisconsin. (February 1999, National Agricultural Statistics Service, Agriculture Statistics Board, USDA)

Constitutional challenges were raised by Senator Kohl. He said "[the Compact] is contrary to everything that is represented by the economic system in the United States." (Con. Rec. S14794 - 11/18/99)

The response is simple. Two major legal challenges to the constitutionality of the Northeast Dairy Compact have been decided unequivocally in favor of the Compact. No decision I am aware of exists that says the Compact is unconstitutional. Since the Constitution specifically provides for Compacts it is hard to fathom how Compacts would be unconstitutional. Note that in

Milk Industry Foundation v. Glickman. 132 F. 3d 1467 (D.C. Cir. 1998) the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's decision that the compact was constitutional and that the Secretary of Agriculture's findings of the Compact in "the compelling public interest" satisfied the requirements of the Federal Administrative Procedure Act.

Also in **N.Y. State Dairy Foods Association v. Northeast Dairy Compact Commission. 198 F. 3d. 1 (1st Cir. 1999)** , the First Circuit Court of Appeals affirmed the U.S. District Court's entry of summary judgement in favor of the Commission. In doing so the court rejected arguments that the Commission's regulations, or applications of the regulations, were not consistent with the Commerce Clause, the Compact Clause, the Equal Protection Clause and the Due Process Clause of the U.S. Constitution.

> Specifically, the Court affirmed the Compact Commission's broad Congressional authority as granted by Congress, including the authority to collect payments for milk originating outside the Compact region shipped into New England. By allowing payments back to the out-of-Compact producers, the Court stated the Commission could even be said to encourage the entry of such milk into the Compact region.
>
> In addition, the Court gave due process approval to both dairy farmer and processor participation in the Commission's rulemaking. Consumer representatives and state officials are also members of the Compact Commission.

Thank you again Mr. Chairman for holding this hearing.

Peter G. Fitzgerald

Statement of Senator Peter G. Fitzgerald
Agriculture Committee Hearing
Federal Dairy Policy
Wednesday, February 9, 2000

Good morning. Mr. Chairman, I appreciate you scheduling this hearing and thank the panelists for joining us today.

Today, we take a close look at our nation's dairy policy. As a member of this committee, I am committed to ensuring that the United States' milk marketing policy is practical, fair, and efficient. Unfortunately, some aspects of our dairy policy don't pass the test.

Dairy compacts, a method currently used by the New England states to raise milk prices, are essentially small cartels that set an arbitrary price floor, and which have led to higher milk prices for consumers. Such an arrangement, along with the proposed Southern Dairy compact, will have an adverse effect on Illinois consumers, dairy farmers, and food processors. In response, I have cosponsored S. 916, the Dairy Fairness Act, which would repeal the Northeast Interstate Dairy Compact. I hope that this committee can mark-up this legislation in the near future and move these much needed reforms forward.

As we all remember, before approving the Fiscal Year 2000 Agriculture Appropriations bill, Congress voted to drop provisions to permanently extend the Northeast Dairy Compact and to create a Southern compact. The defeated measures would also have preserved the current dairy price support system and prevented the implementation of the USDA's market-oriented milk marketing plan. As we all know, this vote came after the issue was fully debated on the Senate floor, its proper venue.

Then, as Congress neared the end of consideration of the remaining appropriations bills for fiscal year 2000, several members again tried to attach the language that Congress had previously rejected, to the Consolidated Appropriations Act. This time, they inserted the provisions when the bill was under consideration in conference, and it was eventually signed into law despite the staunch effort by several of our colleagues to prevent its passage.

I was disappointed that conference members included such a provision in the conference report -- especially after both the House and Senate had previously rejected an identical measure after a full debate on the floor. As we reconvene to begin this session of Congress, I am hopeful that we can revisit these issues and fashion a fair and equitable dairy policy.

One positive policy provision can be attributed to last year's dairy debate – a dairy forward pricing pilot program. I hope Mr. Clayton can update us today on this program's implementation at USDA. Many members of this Committee are interested in providing farmers with additional risk management tools, and the milk forward pricing pilot program provides dairy farmers a much needed risk management tool. Milk forward pricing is particularly important given the wide fluctuation in milk prices that occurred over the last few years.

Mr. Clayton, I would appreciate you taking a few messages back to Agriculture Marketing Service Administrator Merrigan, Undersecretary Dunn, and Secretary Glickman on the milk forward pricing pilot program. First, follow the Congressional intent of the statute and make the program effective March 1. Second, publish broad guidelines as soon as possible in order to give dairy producers and processors the necessary details of how the pilot program will operate. And, finally, do not hinder this program with a regulatory structure that makes the program inoperable.

Dairy farmers and processors need this important risk management tool. Please let the Secretary and others at USDA know the importance of making the milk forward pricing pilot program available by March 1 and the importance of implementing it in a way that producers and processors find meaningful.

Again, I thank the panelists and look forward to hearing your ideas on this important issue.

Suiza
FOODS

STATEMENT OF GREGG L. ENGLES
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
SUIZA FOODS CORPORATION
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

February 8, 2000

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify today about dairy policy from the perspective of the fluid dairy processor.

First, let me make clear, as the nation's number one fluid milk processor, we are absolutely committed to the economic viability of our nation's dairy farmers. Dairy farmers are our partners, and they must have a fair and steady stream of income. Without them and the safe and reliable raw milk they produce, we simply cannot operate. Dairy Farmers of America (DFA), the country's largest dairy farmer cooperative, now owns 34% of Suiza's fluid dairy operations. Therefore, our interests are even more aligned than ever before and we share a common goal – to advance and strengthen the dairy industry.

With that said, let me begin by describing what I believe to be the biggest challenges facing the dairy industry. First, and most importantly, we are experiencing significant declines in the consumption of fluid milk. Over the last 25-plus years, per capita consumption of fluid milk in the United States has steadily declined (See Exhibit A). Why is fluid milk consumption declining? Certainly one explanation is the increased competition from the food and beverage industries. To their credit, these industries have done a far better job of product innovation and marketing than the dairy industry. Today's consumers have many choices from many very appealing competitive beverage and other products. These products range from soft drinks, juices, soy beverages, fortified sports and other beverages to innovative food products, including calcium-enriched orange juice, breakfast bars, waffles and breads. As a result of this wide array of choices, consumers are opting, at an alarmingly increasing rate, for beverages and nutritional sources other than milk. This trend of declining consumption is a serious threat to the viability of farmers and processors alike. It <u>must</u> be reversed. It is only the dairy processing industry that can reverse this trend by bringing the same levels of marketing and innovation to the dairy industry that the food and beverage companies have brought to their industries. That requires scale players and the investment of tremendous resources that only large companies can bring to bear.

Suiza Foods and other fluid dairy processors are working very hard to bring product innovation and marketing to life to reverse the trend of declining fluid milk consumption. But, as an industry, we are constrained by the archaic and inequitable milk pricing system Congress has allowed to continue.

As you all know, our existing federal milk pricing system was developed in the early 30's in response to market conditions existing during the Depression era. Low milk prices, due to the loss of purchasing power by consumers and the collapse of the economy, required emergency legislation that created the first federal milk marketing orders. Although our milk pricing system has been modified from time to time, its purpose has always been to (i) establish orderly marketing conditions, (ii) to ensure sufficient supply of raw milk and (iii) improve the economic conditions of dairy farmers.

The system sets minimum prices processors must pay for raw milk. Those prices differ depending on whether the processor uses the raw milk to manufacture fluid milk (Class I), sour cream or cottage cheese (Class II) or cheese or butter (Class III), with milk used for fluid bottling bearing the highest price. The logic used to justify setting the Class I price above the Class III price was that the price had to be sufficiently high to bring forth adequate supplies of raw milk for bottling. Thus, if you are in a fluid milk deficit market, the Class I differential should be higher than in other markets that regularly produce surplus grade A milk. The higher price would either encourage more local production or help pay the cost of transporting milk into that deficit market.

This historical rationale is as out of touch with today's reality as the carrier pigeon is to cellular telephones. Fluid milk production and processing are no longer local in nature. Technological improvements have resulted in milk with a longer shelf life. Improvements in our refrigeration and distribution systems and our national highway system have brought milk freely into all areas of our country. New technologies, such as ultra filtration and reverse osmosis, are rapidly blurring regional production differences even further. Milk now regularly travels from coast to coast. In addition, our nation's supply of milk has been steadily increasing. Over the past 17 years, the amount of raw milk produced per cow in the U.S. has increased nearly 50% while the number of milk cows has steadily declined. (See Exhibit B.) With a stable and increasing supply of milk and improved production and distribution capabilities, we no longer need artificial pricing mechanisms to establish orderly market conditions or ensure a sufficient supply of raw milk. Clearly we are now operating in an environment where the market forces of supply and demand can and should be allowed to set the price of milk to be paid to the farmer.

Notwithstanding these significant changes in our economy and in the dairy industry since the Depression, Congress has been unwilling to move the industry to an unregulated status. Yet, Congress seems content to allow our current system to continue to charge processors of fluid milk higher prices than those charged to other dairy processors. These higher prices essentially tax fluid milk processors and our fluid milk consumers. These higher Class I prices raise the cost to fluid milk processors, which are passed on to retailers and ultimately to fluid milk consumers as a hidden tax on fluid milk consumption. As we know from experience in many areas, consumers will avoid paying even hidden taxes reflected in artificially high prices by choosing substitute goods. The higher price charged to fluid milk processors increases costs to consumers and drives down consumption. The decline in consumption will, in turn, reduce dairy farmer income unless, of course, Congress is willing to authorize additional subsidies at taxpayers' expense.

In the recent Omnibus Budget Reconciliation Bill, Congress did approve federal order reform, but Congress also increased the Secretary of Agriculture's recommended Class I pricing to a higher Class I differential. I simply cannot understand what public policy is served by perpetuating and even increasing the cost differentials to fluid milk processors and consumers. The burden of sustaining dairy farm income already falls disproportionately on fluid milk processors and consumers. These recently enacted higher Class I differentials raise the hidden tax on fluid milk, and increase an already disproportionate burden on fluid milk consumers. Furthermore, in the Omnibus Budget Reconciliation Bill, Congress also allowed a forward pricing program to smooth price volatility for all milk – all milk, that is, except milk used for Class I fluid processing. Again, processors of fluid milk have been penalized. Then, to further exacerbate these inequities, Congress authorized the extension of the Northeast Dairy Compact to September, 2001, continuing the higher pricing in New England (for Class I milk only, I should note) above the federal order price.

I believe that interstate dairy compacts are one of the more misguided, counter productive legislative initiatives this country has seen. Interstate dairy compacts set a minimum price that fluid milk processors must pay producers of raw milk. Dairy compacts were established with a single purpose: to raise the price of raw milk used for the manufacture of fluid milk (Class I milk) above the prevailing federal price - - not the price of milk used to make other products like cheese, but just the price of milk used for bottling!

As of January 2000, raw milk processed for bottling in the New England Compact states costs $16.94 per hundred weight, while that used to make cheese costs $10.05. That's a **69%** premium for an **identical** ingredient. This premium borne by fluid milk processors raises the price of fluid milk to the consumer. Therefore, is it any wonder consumers view cheese as a better nutritional value for their dollar, driving growth in cheese sales, while fluid milk sales have declined? If we continue to try to enhance dairy farm income by taxing fluid milk sales alone, we will ultimately drive the category down to the point where we have insufficient volume to support farm incomes.

Not surprisingly, at the same time that fluid milk consumption is declining, New England dairy farmers, who are receiving more money for their milk, have increased production. Milk production in New England has grown far faster as a whole than in the U.S. since the Northeast Dairy Compact began. (See Exhibit C.) This increased production, together with decreased consumer demand, has resulted in excess production. Some of this excess production has been absorbed (at lower costs) in neighboring states, driving down prices at which dairy farmers in those states can sell their products and some has been purchased by the government as surplus production.

Understandably, dairy farmers in other states would also like to receive higher premiums for their products. What rational dairy farmer or other businessperson would oppose a program to subsidize his business? However, if that is the course you choose, and you authorize compacts for other states, dairy farmers in those states will also increase production. Then, on an even larger, regional or national, scale the cost of milk to the consumer will increase and consumption will decline. This imbalance of supply and demand is a deadly downward spiral that, ultimately, must result in you, Congress, getting back in the business we have struggled as a nation to put behind us, namely, buying the excess production. To extricate yourselves from such a cash subsidy, which in the early 1980s exceeded $2 billion per annum, you might then take taxpayer money and pay dairy farmers to slaughter the cows which, in turn, would devastate beef prices and have cattle ranchers knocking on your door in anger seeking relief for themselves. Surely we have learned from the mistakes of the past and must not let history repeat itself.

Unfortunately, while the distortion in market forces caused by federal legislation is occurring, the purported benefit of the Northeast Dairy Compact – protection of the small dairy farmer – has not been realized. During the first year of the Compact, dairy farms in New England declined at a 25% faster rate than during the previous two-year period. Dairy farmers in New England, and elsewhere in the country, have been exiting the business on average at a rate of 5% per year. That decline is due, according to the American Farm Bureau Federation, not to milk prices, but to the increasing age of farmers, the unwillingness of children to take over the business and the attractiveness to the farmers of market prices for their land. Our economy has created many opportunities and alternatives for our farmers and their families. There are many among us who believe that this represents progress and an intended result of a prosperous capitalistic economy, rather than a case for continued government intervention.

Before I conclude my remarks of what the Northwest Compact has not achieved, let me say one thing it <u>has</u> achieved: it has benefited a handful of <u>large</u>

New England dairy farms who receive the lion's share of payments from the Compact. But, this marginal benefit has come at the expense of consumers (including low-income families and food stamp recipients) who have paid $85 million more for milk than they would have paid without the Compact, and at the expense of the dairy industry as a whole.

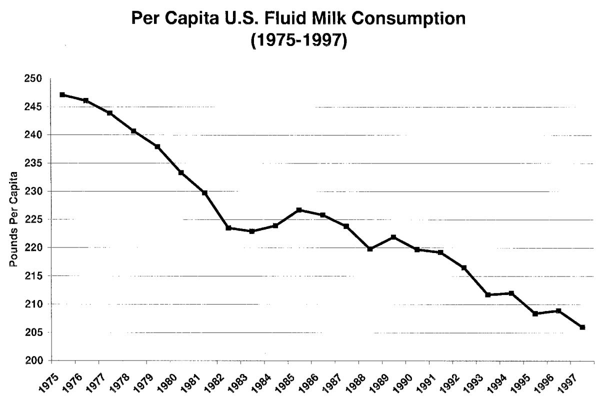
In summary, the dairy industry is complex and so are the issues surrounding it. But the solution does not have to be complex. First, Congress should not authorize any additional interstate dairy compacts and should put an end to the existing Northeast Dairy Compact. We must put the national interest of strengthening and advancing the dairy industry and competing effectively for the consumer's dollar, above the regional interests of a select few. Second, we must move toward a system of pricing of milk that is transparent and simple and that allows processors to compete in a free market where prices are based on supply and demand. Such a system should no longer require fluid milk processors (and fluid milk consumers) to disproportionately bear the burden of supporting dairy farmers through an ineffective and archaic pricing system that no longer reflects the realities of the market.

My vision for the future of this industry is clear. I see a vibrant and growing industry. I see technological innovation reducing costs to the customers. I see product innovation and marketing creating new products, attracting more consumers and increasing their consumption of fluid dairy products. And finally, I see our 18,000 hard working and dedicated employees at Suiza Foods having a reason to feel secure about their futures and excited about their industry and the opportunities it creates for them and their families.

We can make this vision a reality – but we need your help in creating a playing field that is not constrained by the heavy hand of government regulators. Like every other successful industry in our country, we need market forces to drive supply and demand and set prices. And we need Congress to have the wisdom and courage to take a stand and seek market-oriented solutions which address the needs of all constituents in the industry – our dairy farmers, our dairy processors and our consumers.

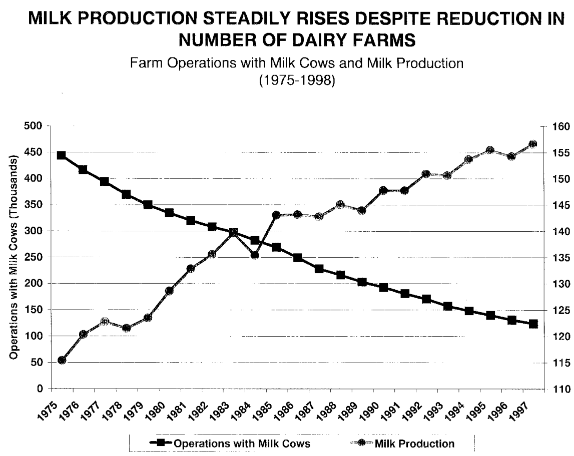
Thank you.

Exhibit A



Prepared by IDFA 2/7/00 using data published by USDA

Exhibit B

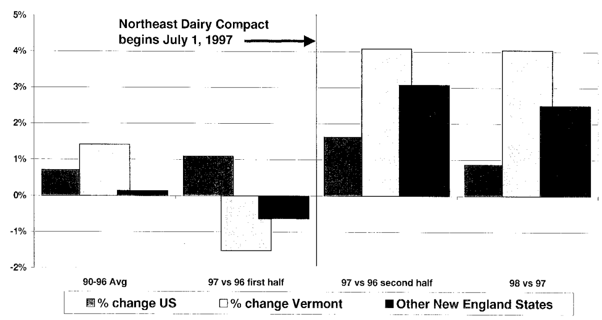


Prepared by IDFA 2/7/00 using data published by USDA

Exhibit C

MILK PRODUCTION IN NEW ENGLAND GREW FAR FASTER THAN INTHE U.S. AS A WHOLE SINCE THE DAIRY COMPACT BEGAN

Year-over-year Percent Change in Milk Production



Prepared by IDFA 2/7/00
using data published by USDA

Statement of the Indiana Professional Dairy Producers

To the Committee on Agriculture, Nutrition and Forestry of
The United States of America
February 8, 2000

Presented / delivered by Martin (Mike) Yoder, Middlebury, In.

Dairy farming has been one of U.S. agriculture's bright spots. Especially the last two years which have been record years in terms of prices received and, because of low feed prices, profits. A number of farmers have used this period as an opportunity to expand their operations and improve efficiencies. These expansions have, in turn, created shortages of replacement dairy animals. Some dairy farmers have taken advantage of this opportunity to sell their operations and retire from the rigors of a 7 day week/24 hour day occupation. Others have sold their milking herds and are utilizing their facilities to raise replacement heifers for other dairies. I believe that, for the most part, dairy farmers are operating from healthy financial positions and are well situated to deal with a short period of low milk prices. Although some would say that the current prices are disastrous, I would differ.

Cost of Production

Examination of the current low milk price compared with some actual costs of production, demonstrate that the two numbers are very close together for most dairy farmers. For the year 1999, our farm's cost of production was approximately $15 per one hundred pounds of milk produced. This is higher than normal because we were expanding the dairy herd. For the year 2000, our projected cost of production is a more normal $13.45 per one hundred pounds of milk. This correlates well with data from Universities that benchmark dairy costs of production. They indicate a range of $13.20 to $16.80 per one hundred pounds of milk, with larger dairies being the more efficient and smaller dairies (less than 80 cows) carrying the higher costs. The price we recently received for December milk was $13.50. This price is what I refer to as our "mailbox price". This price started out with an October Basic Formula Price of approximately $11.50 per hundred pounds of milk. It appears that our farm's January mailbox price will be approximately $12.50. In addition to the mailbox price, we generally add another $1 per hundred pounds of milk sold through the monthly sales of cattle. Again this is in line with the University data. Although the gross dollar income of $13.50 to $14.50 per hundred is not as much fun as $18, or higher, it is a far cry from disaster for most farms, providing these prices do not persist for the long term.

Milk marketing and managing price risk

It is no secret, that how milk is priced is the second greatest mystery known to man. Even after a concentrated effort on my part to learn, I still can not explain it to the average person without an extensive set of notes. In the past, dairy farmers have never needed a good understanding of how milk was priced or any particular marketing skills to market their product. We just shipped the milk off every day and received a check twice a month. There were not many choices for improving our price. And milk prices received, were generally very stable because of the Federal Order pricing mechanism. That has all changed. The last two years the industry has experienced significant volatility in prices, which is something we are not accustomed to managing. There is little doubt that some dairymen would like to return to the days of more stable prices, but I am not convinced this is especially important. I believe dairy farmers can learn to manage a more volatile market, with a few provisions.

First, confidence in the futures market needs to be restored. Last year's wide price swings were due, in part, to inaccurate reporting of stocks on hand. As a result there is a general perception, among dairy farmers, that this was the result of purposeful market manipulation by large processors. Since there already existed some skepticism among dairy farmers concerning the use of futures, last years experience will make it even more difficult for many to adopt this management tool. More accurate reporting of dairy inventories must occur.

Expanding the Dairy Options Pilot Program might be helpful as well. This program will be offered in my area this year, I plan on taking advantage of this opportunity to learn more about pricing our milk using futures and options. Although I have used these tools to market grain and understand the basic concepts, I have not used the dairy futures because I have not yet learned how the futures price is tied to my mailbox price. Nor is there an abundance of data to help relate current stocks of dairy products to future price.

Perhaps some of the volatility has already been taken care of with the new Federal Order pricing structure implemented January 1 of this year. Dairy farmers have wished for a simplified pricing mechanism, a way to price milk more closely to its end use and a price that reacts more quickly to market signals. It seems like that is what we now have. However, since no one has actually received a milk check based on the new Federal Order, it is too early to judge as to whether it accomplishes that goal.

Milk is unique in that the farmer does not have the opportunity to store and market at his will. If I were able to control the powder and cheese portion of the milk produced on my farm, it is possible I would not put it on the market at this time. I might choose to pay storage and wait for better prices. As it stands now, the co-op or processor, stores the processed dairy products. Once prices improve the stored product is then sold and the party selling captures the additional profit. The farmer has no method of capturing a portion of this profit. Although I have no specific proposal to present that would improve this situation, members of our organization do express an interest in having the ability to retain ownership of a portion of the product they produce.

Support Price

It is our understanding there is some talk of keeping a support price, but with modifications to tie it to an average cost of production. We strongly urge that a support price NOT be attached to cost of production calculation. We agree that some type of support price should be kept in place. but we prefer a structure that does not build significant, government held, stocks of dairy products. A very low safety net is probably a good description of our concept of a support price.

Dairy Imports

Closely related to milk price is the issue of dairy imports. Examining USDA dairy import data suggests we are importing significant amounts of dairy products. FAS data indicate Jan. -Oct 1999 imports valued at $1.047 billion in 1999. This compares to only $930.4 million during the same time period in1998. Some of these imports are products used in cheese production here in the U.S. and are exempt from any current import quotas. We are concerned that the U.S. has become the sponge of choice when there is a need to soak up surplus dairy products produced elsewhere in the world. During times of excess production in the U.S., we do not believe it makes sense for the U.S. government to purchase surplus domestic dairy products, especially cheese. that are manufactured using foreign produced surplus dairy components. This amounts to using our tax dollars to help solve other country's dairy surplus problems.

I do understand the need to be a good trading partner in order to increase market opportunities for our agricultural products. However, anecdotal evidence from Indiana producers who have traveled to New Zealand, suggests that milk production quality standards are substantially lower than standards under which U.S. milk is produced. We have the same concerns about milk produced in European countries. We are aware of reports that these foreign products can be purchased, and shipped here, for less than U.S. products can be purchased. That seems a bit incredible to me. If these products are actually being exported without subsidies, there must be other reasons why the cost is lower. We are suspicious that production regulations may be the reason. Since labeling appears to be the solution of the moment, in regards to some trade disputes, perhaps all dairy products produced in the U.S., which contain foreign dairy products, should be so labeled. At the very least these products should not be labeled with the REAL seal, which is funded by the U.S. dairy industry.

Another component of the import issue concerns accurate classification. There appears to be a common practice among exporters of reclassifying, or modifying dairy product processing, so that the dairy import falls outside of the U.S. dairy classifications that contain import quotas . It only seems appropriate that this type of trade policy abuse be discouraged. The reason current milk prices are low is because of surplus cheese inventories. Some dairy farmers believe these surpluses were created using misrepresented dairy imports.

Class III and Class IV

A concern that has been raised with the new pricing structure is the establishment of the class I price mover by taking the best of class III price or class IV price. Although the initial results have been positive for dairy farmers, there is some concern about the possibility of manipulating these two prices. Limited trading occurs in these two classes and a large co-op, or processor, could time purchases in such a way as to dictate which class might be used. Under this scenario the price of grade B milk, which is used only for manufactured products, could be arbitrarily pushed so low that our Amish dairy producers would be forced to sell their dairy herds. This would affect smaller cheese plants purchasing grade B milk. During times of tight milk supplies, these cheese plants could not afford to purchase all their milk needs at grade A prices and would therefore not be competitive. Closure of these plants would have significant impacts on our communities. There is concern that we not lose processors, we recognize the difficulties that arise when you have few, or only one, options to market your milk. The hog industry taught us that lesson. One suggestion is that a blend of class III and class IV be used every month, instead of the current -best of- procedure.

Dairy Compacts

I would be remiss if I did not comment on dairy compacts. At the request of Indiana's Commissioner of Agriculture, dairy representatives from across our state spent 1999 studying dairy compacts. The catalyst behind this study was the possible expansion of the Northeast Dairy Compact and the establishment of a Southern Dairy Compact. Indiana was interested to learn the impact such expansions would have on our Indiana dairy industry if Ohio and Kentucky both joined a compact. After a year of studying, including presentations from both Vermont's Commissioner of Agriculture and representatives of the proposed Southeast compact, our committee concluded that dairy compacts carried more negatives than positives and that any expansion of dairy compacts could have a detrimental effect on Indiana dairy farmers.

From our perspective, by arbitrarily establishing a floor for class I milk, dairy compacts establish a price for milk that is contrary to a free market based philosophy. The dairy industry has been striving to establish a milk pricing mechanism that more quickly responds to market usage, sending appropriate signals to the dairy industry. A compact does the exact opposite by attempting to artificially sustain higher prices. The result is lower consumption, higher production. For a neighboring state, outside of the compact, the consequences would not be favorable. First, for Indiana dairyman shipping milk into the compact, the initial impact would be higher prices, however since there are penalties for a compact producing surplus milk, we believe the Indiana dairy farm would be the first place a processor would look if needing to reduce supply. Second, the surplus production could easily be shipped into Indiana for processing, thereby lowering our class I utilization and lowering the price our dairy farms would receive. Of course any surplus production that moves into other milk processing streams, reduces the milk price for farmers outside the compact. It comes down to Indiana being forced to establish its own compact to protect our dairy farmers, or join someone else. Unfortunately, we are not on anyone's list and we received no invitation when we asked the Northeast and Southern representatives.

We concluded that any pricing scheme that attempts to separate clear market demand from price paid, is a plan for eventual mountainous surplus. Especially when the scheme includes some method of trying to incorporate an average cost of production, which a dairy compact does. Compacts are not a good idea, the concept needs to die, or at the very least, not be allowed to spread.

Environmental Regulations

We believe that environmental concerns are best solved at the state level. Indiana has been very active in developing on-farm approval procedures for manure management. Our Indiana Department of Environmental Management is currently working with agriculture groups to develop new regulations for our industry. Without question, the discussions have been heated, as we attempt to develop regulations to protect Indiana's water resources. Our livestock industry has attempted to move the proposed regulations from a general prescriptive type to individual, farm based, management plans; an idea we believe will result in workable and reasonable manure management plans. Progress is being made. Adding a federal requirement to this process would be extremely cumbersome and would not guarantee better environmental protection. In fact, we believe it would most certainly add unnecessary regulations and expense to our livestock operations.

Testimony of

Dairy Farmers of America, Inc.

Presented to the

Senate Agriculture Committee

Tuesday, February 8, 2000

Presented by:
John J. Wilson
Corporate Vice President of
Marketing/Economics Analysis

Good morning Chairman Lugar and Committee Members:

My name is John Wilson. I am Corporate Vice President of Marketing and Economic Analysis at Dairy Farmers of America (DFA). I am speaking on behalf of the 24,200 dairy farmers who own our cooperative.

DFA is a dairy cooperative that is owned strictly by dairy farm families. Our purpose is to market all the milk produced every day by our members at a fair return.

DFA's owners operate dairy farms in 45 states and will produce about 21% of the US milk supply during 2000.

DFA is structured to assure dairy farmers control the organization. To ensure that the cooperative serves its local members and customer needs on a daily basis, DFA maintains a grassroots structure made up of seven area councils, based geographically on the number of member farms and milk production. Each area's marketing strategies and policy development is set up and controlled by an area council made up of dairy farmer members who are elected by the area's farmers. Each area council elects representatives to the corporate board which oversees the policy development and direction of DFA. To ensure even more grassroots participation, each area council has district leadership, delegate, and resolutions structures that allow for many voices to contribute to the direction of their cooperative.

On behalf of the members of DFA, I want to express my appreciation for the action Congress took to correct the Federal Order Final Rule. As you recall, USDA attempted to lower dairy farm income by lowering Class I differentials that processors are required to pay farmers. This action was reversed by Congress with the passage of the Consolidated Appropriations Act, 2000. Also, by requiring USDA to hold formal hearings for the purpose of reconsidering Class III and IV prices, Congress is helping dairy farmers to get a fair shake from USDA. Congress sent a clear message that it was not their intent to lower farm income when it called on USDA to reform Federal Orders.

DFA strongly supports Federal Orders for these reasons: 1) Federal Orders establish minimum farm prices; 2) they assure consumers of a steady supply of fresh milk; and 3) they provide for orderly marketing.

The basic purpose of the Federal Order system is to establish minimum farm prices at a level that assures consumers of a sufficient quantity of milk. In doing so, Federal Orders classify milk according to how it is used and establish minimum prices for each class.

This economic principle is based on the fact that consumers place different values on milk depending on how it is consumed. Fluid milk (Class I) commands the highest value. Dairy farmers deserve to get a portion of the added consumer value attributed to milk. The Federal Order system is the best tool to make sure that happens.

This system brings order to a market that is naturally out of sync because of two simple realities: 1) milk is highly perishable, and 2) cows produce milk on a much different schedule than consumers drink it.

Milk's perishability requires it to be sold by the farmer every other day. Seasonally, the supply and demand for milk do not match up. Production of milk (primarily because of the seasons of the year) increases in the spring and declines in the late summer and fall. Consumer demand for milk is just the opposite -- the need for milk is heaviest in the fall and lightest in the late spring and early summer. Within a given week, the demand for milk is not the same from day to day. Since many consumers do their grocery shopping on weekends, the demand for milk is heaviest toward the end of the week. Since within a week, the supply of milk is not likely to vary significantly, farmers must have an alternative use for their milk on the days the bottling plants don't want to purchase it.

This means in order to have a sufficient supply for consumers every day of the year, we must have more supply than is needed on most days. This puts dairy farmers at a competitive disadvantage to investor-owned processing plants when negotiating for prices. This situation caused Federal Orders to become public policy in 1937. The need for the system has not changed today.

An unregulated milk market would be extremely disorderly with investor-owned processing plants taking advantage of dairy farmers during times of excess supplies. Federal Orders can not completely solve the problem, but they do play a major role in equalizing the imbalance of bargaining power between producers and purchasers of milk. For these reasons, DFA strongly supports Federal Orders.

The economic environment in which today's dairy farmer must operate is a tough one. Price volatility is the name of the game. Within the last two years, the Class III price (formerly known as the Basic Formula Price) has been as high as $17.34 and as low as $9.63. Incidentally, the $9.63 was for December of 1999. The last time the Class III price was this low was July 1978, over 21 years ago! Obviously, dairy farmers are not very happy about current price levels.

The foundation for Federal Order prices and consequently farm prices is a composite of the value of cheese, butter and nonfat dry milk. Cheese and nonfat dry milk are currently trading at or very near the support price. The butter price is somewhat stronger, but it has a limited effect on total milk prices. Without our dairy price support program, it is likely that cheese and nonfat dry milk would fall to significantly lower levels. Some would say we should let our dairy prices fall to world price levels and thus become "competitive" with the world trade. Based on dairy commodity prices published by USDA, we estimate the world price for milk used to produce butter and nonfat dry milk to be $7.03 per cwt. The comparable price for milk used to produce cheese is $6.68 per cwt. I cannot imagine the impact on our commercial dairy industry if our prices were to go that low. The safety net provided by our dairy price support program is real. We strongly advocate it's indefinite continuation.

DFA will be asking Secretary Glickman to modify the make allowance used in the price support calculation to equal the effective make allowance in Federal Order prices. Currently, if you calculate the new Federal Order Class III price using the commodity prices established under the price support program, the resulting milk price is $9.74, not $9.90 as Congress has mandated. Likewise, if you do the same calculation for Class IV, the result is $9.83 per cwt. It is only fair that Secretary Glickman make the appropriate adjustments to the price support make allowance to reflect the intent of Congress which is to floor the price farmers receive at $9.90 per cwt.

The Dairy Export Incentive Program is a very important tool for the dairy industry. Without this benefit, our dairy farmers cannot afford to export their product in the heavily subsidized world trade. Currently, the world cheese price is approximately $0.78 per pound (compared to approximately $1.10 domestically). The world butter price is approximately $0.61 per pound (compared to approximately $0.97 domestically). The world price for nonfat dry milk is approximately $0.68 per pound (compared to approximately $1.01 domestically). Obviously, if we expect our dairy farmers to be players in the world dairy trade, we must continue to maximize use of the Dairy Export Incentive Program.

Another issue of concern involving world trade deals with cheese standards of identity. We understand the National Cheese Institute may petition the United States Food and Drug Administration to allow the use of imported milk protein in the manufacture of domestic cheese. This is potentially devastating to this country's dairy farmers. Foreign casein (milk protein) or milk protein concentrate has no quota or tariff when imported into the United States. Like other dairy commodities, the world casein price is well below our price due to foreign subsidies. As a matter of fact, the world price is so low, there is no casein produced in the United States. The quantity of imported foreign milk protein would directly displace milk produced by the U.S. dairy farmer. This would be a tremendous slap in the farmer's face if the FDA approves the cheese processor's request.

Governmental intervention is important to assure dairy farmers get a fair and equitable price for their product. However, the government can't provide farmers with everything they need. Dairy farmers need market security. They want to control their own destinies. They are fearful they will be swallowed up like the poultry farmer who has become a piecemeal worker. They look at their neighbors who used to raise hogs and no longer have the ability to compete with the vertically integrated corporations which control the pork industry. They see the beef industry controlled by a handful of buyers.

These fears have caused dairy farmers to create Dairy Farmers of America. Our cooperative is the farmers' answer to a quickly consolidating industry that threatens the livelihood of dairy producers and their future as independent business people. As we look around other segments of agriculture, we see significant vertical integration from the processor back toward the farmer. Dairy farmers use DFA to vertically integrate from the farm *toward* the consumer. The result is that through DFA, farmers have an ownership interest in many processing plants around the country. This gives them market security and perhaps a bigger share of the consumer's dollar.

We believe the United States needs a secure domestic food supply and the best source for that food is from the independent business people we call farmers. We, at DFA, are doing what we can to perpetuate the farming tradition that has made this country the best place to live in the world.

On behalf of over 24,200 dairy farmer members of DFA, I thank you for your time.

Statement of Dennis Vander Stelt
Representing the Western States Dairy Producers Trade Association
And The Idaho Dairymen's Association, Inc

To The Senate Agriculture Committee
February 8, 2000

Mr. Chairman and Members of the Committee, thank you for this opportunity to appear before you today to discuss Dairy Policy with you.

My name is Dennis Vander Stelt, and I operate a dairy in the Treasure Valley in Kuna, Idaho, 20 miles south of Boise. I appear before you today on behalf of the Western States Dairy Producers Trade Association (Western States) and the Idaho Dairymen's Association.

Western States is an organization of ten Western dairy producer organizations, which came together in May 1996 for the purpose of identifying mutual problems and finding common solutions. Our membership—which represents approximately 35% of the U.S. milk production—including all three California dairy producer groups (Western United Dairymen, Milk Producers Council, and California Dairy Campaign); Dairy Producers of New Mexico; Idaho Dairymen's Association, Inc; Oregon Dairy Farmers Association; Texas Association of Dairymen; Utah Dairymen's Association and Washington State Dairy Federation. In addition, we have been working with United Dairymen of Arizona. We actively promote a competitive, market driven, and price discovery system for pricing milk.

I also represent the Idaho Dairymen's Association, which is a trade organization that represents all 932 dairymen in the state of Idaho. They produced 6.35 billion pounds of milk in 1999. The industry in Idaho has been growing in the double digits for the last five years and will continue this pace if the atmosphere continues to be positive for the dairy industry. Cheese is the main use of milk in Idaho, accounting for approximately 90% of the utilization.

We need to ask; "Why do we need to have Dairy Policy?" The nature of our product determines that we should have an orderly marketing system. The shelf life of most dairy products is short because our product is perishable. We would also be in trouble if there were not the mechanism for uniform testing and pricing of the components of milk. There, also, is a need for price transparency in our industry. Producers need to be assured that they are getting the same basic price as everyone else, and processors need the assurance they are paying the same price as their competitors. Because producers must ship milk every day they are extremely vulnerable to discrimination from processors, therefore, history has taught us there needs to be a government enforced system to insure that all producers are getting basically the same prices, and that all processors are paying the same. In our industry milk has to move between regions and have orderly pricing. This is best accomplished under the Federal Order system to assure that everyone is being treated fairly.

Three things have made our industry successful in the past, the Federal Milk Marketing Orders, the Co-op system, and the increase of milk production per cow, which has doubled since 1970.

Dairy looks at some of the other agriculture commodities and is thankful that we are not vertically integrated. If the processor were to own the facilities and the cows, then the dairymen becomes only the hired laborer. But, the main reason that the Dairy Policy, and the Federal Order system needs to be maintained, is to assure an adequate supply of milk for the consumer. This is important all over the country. You can go into any super-market and most convience stores and get your supply of milk at a reasonable price. The price, by the way, is usually below soft drinks, juices, and bottled water, our competition in the market place. Market forces are driving the price for milk on the farm. We are truly in a supply and demand market. With only 1% over production we see prices that fall dramatically.

At the last meeting of the Western States, several policy positions were adopted. First, we are in favor of national programs, not regional programs. Second, we believe that price stabilization, such as the support program, needs to stay in place. Third, we believe that market access programs such as the Dairy Export Incentive Program (DEIP) need to remain. Fourth, we are opposed to direct payments to producers.

What policies do we want? We need the Federal Order system to continue, but would like some corrections in the Class III and IV formulas. This should happen in the next several months.

The Federal Order system does not create surplus milk nor discourage privately owned cheese companies from locating in an area. Idaho is proof of this. Order 135 was established in the early 80's, major cheese companies and major expansion didn't come until ten years later. They could have located in Montana, which didn't have and still doesn't have a Federal Order System. However, they chose Idaho, and we're glad they did.

There should also be a mechanism to stabilize our market. The price support program, now at $9.80, should be left in place. The cost of this program is very small for the taxpayers. In fact, the GAO scored it at zero cost when Congress extended the program until 2001. Most of the time it is far below the price of milk but in times such as these, it helps stabilize the market. Without the price support system the volatility in the market place would be even greater.

There also needs to be a way that the industry can access the world market at prices lower than our domestic prices. DEIP has helped enhance our markets. We would like it to remain in place. We understand the implications with GATT and why it is being phased out, but it has been good for our industry to use, to access world markets and remove product from the normal marketing channels. In fact, if the direct government payment of $125 million was added to the DEIP it would, at the present bonus price of $690 per metric ton of cheese, just about use up the surplus of cheese in the market. The DEIP program also helps with the marketing of dry milk powder, which is used in most areas as a balancing product.

We have our work cut out for us.

What policies do we not want? Direct payments to producers that are unfair and ineffectual in helping producers are a waste of money. Put the money where it will enhance our market such as the DEIP program. Under the present distribution a certain Midwestern state, produced 14.5% of the milk last year, but received 22% of the $200 million Dairy Market Loss Assistance Program payments. Is this fair, or is this suggesting that the western dairymen are a different class of dairymen. This large vs. little is not right. In Idaho, with the exception of one, all our dairies are not publicly financed corporations, but family owned and operated dairy farms. Some are large and some are small, that is America.

The last issue is trade! Let me ask you, "Is there greater danger to opening our markets than there is to expanding exports?" All you have to do is look at some of the other Ag products in our country and you will have to say emphatically, "YES!"

Should the dairy industry export more? It has to be viewed as an additional market. However it is a market that says we can only sell at an amount that is less than our domestic price. We still have reservations about fairness in trade and are unwilling to increase our production just to become exporters. We are not willing to export at a loss. The third world countries would like to develop their own agriculture. They understand that if they are reliant on someone for food that is not a good situation. However, most are a long ways from a domestic dairy program that will work, and in some parts of the world it will never happen. This then is the market. The question is how do we compete without lowering our domestic price below the cost of production?

It is our belief that if our companies are given a chance to develop foreign markets our industry can find ways to meet the lower prices demanded. But, only if the world price is truly a market price and not a dump price from subsidized product. If some of the major countries, like China, Russia, India, and all of Indonesia decide to import rather than develop their own dairy industry then U.S. dairy producers need to be ready to fill those markets.

Once again, leave the DEIP program in place, and as the opportunities present themselves, we can supply the product.

The other side of this equation is the imports! This is important, "Don't trade away our domestic dairy industry for some high tech considerations. Do not allow cheap imports to ruin our industry!" If, in the trade negotiations, the imports of dairy are traded for something else, then the domestic industry will have to shrink. The economic benefits derived from the dairy industry will shrink and rural America will suffer again. We have seen this happen in the sheep industry. Don't do it to dairy! This is not positive for our country. If we can restrict imports to the current levels then our industry will survive and grow.

In closing, just let me say, without these dairy policies I would probably not be here. The dairy industry would be a fraction of what it is now, and we would be importing far greater amounts of dairy products. Americans only see food as a very small part of our economy, but it is the largest part of the world economy. Without government policy, we would have far fewer farmers and far greater imports in all areas of agriculture. Yet, U.S. consumers spend less, on food as a percentage of their income, than any country in the world. This is not an accident but the result of many years of strong government policies that have maintained a healthy and efficient agriculture that is the envy of the world.

Thanks again for letting us share with you.

TESTIMONY PRESENTED TO THE
SENATE AGRICULTURE COMMITTEE

Tuesday, February 8, 2000

U.S. DAIRY POLICY IN THE 21ST CENTURY

GORDON HOOVER
Dairy Producer – Gap, Pennsylvania

Member, Land O'Lakes Board of Directors
Member, NMPF Board of Directors

THE NATIONAL MILK PRODUCERS FEDERATION

nmpf

Good morning, Mr. Chairman, and the other members of the Senate Agriculture Committee.

I'm Gordon Hoover, a dairy producer from the town of Gap, Pennsylvania. My family and I milk 120 cows. My home county of Lancaster, Pennsylvania produces more milk than any other county in the Eastern Time zone.

I'm also a board member of the 2nd largest dairy cooperative in the country, Land O'Lakes. And I also serve on the Board of the National Milk Producers Federation, on whose behalf I am appearing today. As you know, NMPF is the national voice of 50,000 dairy producers on Capitol Hill and with government agencies. We develop and carry out policies that advance the well-being of U.S. dairy producers and the cooperatives they collectively own. The members of NMPF's 28 cooperatives produce the majority of the U.S. milk supply. We also manufacture 45% of the butter, 55% of nonfat dry milk, and 30% of the cheese, marketed in the U.S.

I'm here today to help this committee understand NMPF's perspective on dairy policy, and the future of the U.S. dairy industry from the producer's perspective. I'm glad the Agriculture Committee is taking this opportunity to focus on dairy, which is the second-largest sector of U.S. agriculture, measured by cash receipts, behind beef cattle.

I'd like to address five issues of importance to the dairy industry: the recent reform of the Federal Order program; the future of the dairy price support program; the future of the DEIP program; the need to maintain current cheesemaking standards; and the importance of industry unity.

First, let me briefly address the recently-implemented reforms in the Federal Milk Marketing Order program. I think that's a good place to start, since that's part of the reason these hearings are being held.

I'd like to begin by reminding the committee what the 1996 FAIR Act directed the USDA to do, in order to reform the Federal Order system. There were four primary requirements specified in the dairy title of the Farm Bill:

- Consolidate the number of Federal Orders from 31 into roughly one dozen;
- Use the informal rulemaking process to propose and implement changes;
- That the new Class I differential structure not be based on the existing differential structure, and;
- That the changes be implemented by the Spring of 1999.

How did the USDA do on those four counts? Let's review.

First, there are now, as of Jan. 1st, 2000, 11 consolidated Federal Orders – a two-thirds reduction from the old system.

Second, the USDA did follow the informal rulemaking process as it developed the new Federal Order program. One area during that process that caused some problems was in the determination of the proper manufacturing allowance for Class III and Class IV products. Congress has now directed the Department to use a formal rulemaking process to reconsider the appropriate make allowance for cheese and butter/powder products. In this matter, the informal rulemaking process failed to arrive at a fully-informed conclusion about the make allowance, and we believe the formal hearings the USDA is about to conduct will rectify that problem.

Now, let me address the third point, Class I differentials.

Back in 1998, USDA staff developed two possible approaches for the reform of fluid milk prices under the new Federal Order system: Options 1A and 1B. Both represented a change in prices compared to the existing system. Both had their pluses and minuses. Both generated some controversy. Ultimately, Congress passed legislation last year requiring the use of Option 1A in the new Federal Order system.

Finally, how did they do on the timeframe for reform? The Congress delayed implementation of the new system by six months, and a lawsuit further delayed it by a couple more months. But the reforms were finally implemented at the beginning of the year.

Therefore, Mr. Chairman, we believe that the USDA's final rule has complied with the congressional directive in the Farm Bill. Moreover, we believe that the USDA has established a solid framework for the future of the Federal Order system: one that preserves elements of the existing system that historically have well served consumers, processors and producers; and one that makes significant changes to reflect the realities of the marketplace of the future.

There are many other significant changes in the new system. A brief list:

- Replacing the outmoded Basic Formula Price with a new pricing arrangement using multiple component pricing to better reflect the underlying value of raw milk;
- The reliance on both Class III prices and Class IV prices as the Class I price mover, and the use of four product classifications in all 11 Order areas, not just some;
- The accelerated schedule of advanced pricing announcements whereby the system more quickly reflects changes in supply, demand and price, and;
- The aforementioned consolidation of Order regions to 11, which better reflects the increased movement of milk across the country.

These are important changes, and ones that we believe will make the system more market-oriented, and more workable, for dairy producers and manufacturers, as well as others involved in the milk marketing system.

It will take time to assess all of the impacts of these changes. We are hopeful that we can allow the new system to function without any further tinkering. There are many other issues that are critical to the survival of dairy farmers in all regions of the country.

The second issue I'd like to address this morning is the disastrously low prices we are experiencing right now, and what can be done about them. It's at times like these that I think that dairy farmers should petition to be listed under the Endangered Species Act.

I hope the Senate recognizes the importance of continuing some type of safety net for farmers when we experience extremely low prices. One approach utilized the past two years is the appropriation of tens of billions of dollars in ad hoc farm assistance, including a very modest $325 million for dairy producers in the past two years.

We appreciate Congress allocating money specifically to dairy producers in this fashion, but this form of assistance needs to be bolstered with a true safety net for dairy. In our opinion, the price support program is that safety net. Unfortunately, as part of the 1996 Farm Bill, Congress saw fit to eliminate the dairy price support program at the end of 1999, although a provision passed last year extended it an additional 12 months, through calendar 2000.

Unlike during the 1980s, when the price support was set at levels that encouraged excessive supply, the current support level of $9.90 per hundredweight is not an excessive incentive spurring unneeded production. Believe me, the promise of sub-$10 milk is not going to enhance anyone's cash flow. It simply represents a very modest investment by the government in preventing the complete collapse of domestic dairy prices. The recent collapse of hog prices, and the pain that has caused in rural America, is a prime example of the value of the dairy price support program.

The U.S. dairy industry has operated in a relatively market-oriented environment for close to a decade, with the dairy price support program providing a safety net at a price level that has not stimulated excess milk production. The price support program is the best tool available to U.S. dairy farmers to cope with cyclical changes in prices.

Annually, about 230 million pounds of nonfat milk solids have been absorbed by the dairy price support program. Absent this program, commercial exports would constitute the only outlet for marketing that 200 million-plus pounds of surplus nonfat dry milk. Nonfat dry milk prices would likely drop to artificially-depressed world price levels, which according to USDA, are $0.68 to $0.70 per pound. The current CCC purchase price for nonfat dry milk is $1.01 per pound. NMPF estimates that discontinuing the CCC standing offer to purchase nonfat dry milk under the dairy price support program would reduce dairy producer revenue by about $2.7 billion per year.

The best option for addressing the ups and downs of the agricultural business is to continue the price support program after January 1, 2001. Last week, Secretary Glickman, in unveiling the Clinton Administration's proposal for improving the farm safety net, expressed support for a two-year extension of the dairy price support program. We urge this committee to endorse that proposal and extend the program through the lifespan of the FAIR act.

Every dairy producer organization in this country supports this extension, and there are no regional disputes involved. We have unanimous agreement among producers on this point.

I'd also like to briefly address an additional threat to domestic prices: Imports that will circumvent and undermine the legitimate, hard-fought tariffs we worked to achieve in the current World Trade Organization agreement. Already we face a situation where heavily-subsidized milk caseinates produced by other countries can flood into this country and displace domestic milk products. But now, to make matters worse, there will soon be a petition by the National Cheese Institute to change U.S. cheese standards to allow the use of imported milk proteins as an ingredient in cheese.

Mr. Chairman, such a change would be extremely damaging to U.S. dairy farmers, because unlike the European Union and many of our international competitors, the U.S. has no significant quotas or tariffs to limit imports of milk protein concentrate. Milk protein concentrate produced by heavily-subsidized foreign dairies could be exported to the U.S. for less than it costs to produce a similar product here. And that foreign milk supply would directly displace billions of pounds of U.S.-produced milk that is now used to produce cheese.

I believe it's worth noting that the dairy cooperatives that belong to the National Cheese Institute oppose this petition to the FDA regarding a change in cheese standards. Unfortunately, the producer-owned cheesemaking organizations belonging to NCI were outnumbered in that vote, but I hope you will see this is a divisive issue that is not good for the domestic milk prices. I hope this committee will monitor this issue very closely, and give thoughtful consideration to the economic calamity that would be produced by such a change in cheese standards. We are disappointed that some of our own U.S. processors seem to lack a sense of compassion for, and loyalty to, U.S. dairy producers on this issue.

One final note about prices and international trade: I think the recent failure to launch new WTO negotiations in Seattle should give us all pause to think about the competitive position of U.S. agriculture. NMPF certainly supports all efforts to reduce international dairy subsidies, since they grossly distort the world market and depress prices. However, as long as the European Union and other exporting regions continue to rely on various subsidy programs to augment their exports, the U.S. cannot afford to unilaterally disarm itself. We have our own modest government system, the Dairy Export Incentive Program (DEIP), to help move products overseas.

DEIP allows the U.S. dairy industry to compete in a limited way with the much more extensive export subsidy practices of some of our export competitors. For example, the

E.U. accounts for almost three-fourths of the dairy export subsidy volume permitted among WTO members, when measured on a milk equivalent basis. DEIP exports by the U.S. are limited to just three percent of this same total. And while Canada will be limited to roughly half the milk equivalent volume permitted under the DEIP, Canada's dairy industry is not much more than one-tenth the size of the U.S. industry, and we had to go to the WTO to force Canada to stay within its limits.

DEIP also acts as a market development tool for U.S. dairy products in a very distorted market. This is why we strongly believe Congress should extend the authority for the DEIP, which currently expires at the end of 2002, and push to ensure that USDA uses the program to the full extent we are allowed by our commitment to the WTO, as provided in the 1996 FAIR Act. Especially during a time when we're seeing both extremely low domestic prices and serious questions about the world market for agricultural trade, now is not the time to give up on the DEIP program.

Finally, Mr. Chairman, I'd like to end this testimony with a discussion of how we in the producer community are looking at future dairy policy issues.

First of all, a larger percentage of dairy producers than ever before, about 84%, now market their milk through farmer-owned cooperatives. We have seen what has happened in other agricultural sectors like pork and poultry, where independent producers have been shoved aside by huge, vertically-owned conglomerates. I believe the dairy sector is unique in having seen the value of dairy farmers working together to market their product. As I said earlier, it has not meant a windfall for our industry, because cooperatives or not, we all face pricing pressures. There are no magic bullets.

But I believe only by working together within our coops can we hope to balance the power in the marketplace of multinational corporate dairy processors and retailers. The marketing power of the giant conglomerates of the world needs a counter-balance in the form of strong and healthy dairy cooperatives, owned by farmers for the benefit of farmers.

We in the dairy producer sector know that last year's contentious debate over dairy policy has created some rifts that need to be mended.

That's why the National Milk Producers Federation has taken the lead in sponsoring a new initiative, the Dairy Producer Conclave, to refocus the energies of dairy producers and find areas of agreement within our community. As Abraham Lincoln noted long ago, A house divided against itself cannot stand. We need some home improvements in dairy.

So, NMPF is working with other national farm groups right now to arrange five regional grassroots sessions this spring to receive input on issues of importance to the industry, such as Animal Health, Environment, Economic Policy, Product Standards, Trade, and Food Safety. After the regional sessions, our steering committee of national dairy leaders will consider the input we've received, and attempt to build a consensus program of issues for the future.

NMPF is being joined in this effort at the national level by the American Farm Bureau, the National Council of Farmer Cooperatives, the National Farmers Organization, the National Farmers Union, and the National Grange. At the five regional sessions, individual producers and producer groups in those regions will be invited to participate in this consensus-building endeavor. All of these groups recognize the importance of moving beyond the debate we conducted last year. We hope that by finding areas of consensus on the issues I just mentioned, we can focus on the challenges that lie ahead.

We intend to complete this process by December 31st, and will be back to this committee, and to your colleagues on the House Agriculture Committee, with our ideas and plans. Dairy producers must try to resolve our regional differences first, and then attempt to reach consensus with the processing segment of our industry.

We have already completed our initial planning committee meeting, and now have set the dates for the five regional grassroots meetings. NMPF is serious about unifying producers and working together with those in the processing segment who also are willing to work toward a consensus in the future.

Dairy policy should not only be about milk prices, but also include all of the areas that affect by bottom line as a producer.

With that, I'd like to thank you for the opportunity to testify today, and I'll be glad to answer your questions.

Gordon B. Hoover

Gordon Hoover is a dairy farmer from Gap, Penn., in Eastern Lancaster County. His operation consists of a herd of 120 registered Holstein cows plus replacement stock and 188 acres of corn and alfalfa. He and his wife, Carole have three daughters.

Mr. Hoover is a member of Land O'Lakes and has served on the cooperative's Board for two and a half years; he's currently the Secretary of the Board. He previously served for five years as director of the Atlantic Dairy Cooperative. ADC merged with Land O'Lakes in April 1998.

Mr. Hoover has spent 20 years as a full-time dairy farmer. In that time he's been active on many local, state and regional farm and civic organizations. He currently serves on the National Milk Producers Federation board of directors, Lancaster County Farm Bureau's legislative committee, Salisbury Township's Zoning Hearing Board, a 4-H Dairy leader and Limeville United Methodist Church Administrative Council Chairman and also as a Sunday school teacher.

WISCONSIN FARM BUREAU FEDERATION

Testimony

of

Richard Gorder
Mineral Point, Wisconsin

before the

Committee on Agriculture, Nutrition, and Forestry
United States Senate

February 8, 2000

Thank you, Mr. Chairman and members of the Committee for the opportunity to appear and testify before you today.

I am a dairy farmer from Mineral Point, Wisconsin. I am, by today's standards, a small dairy farmer, farming 200 acres and milking 50 cows. I am also a member of the Board of Directors of the Wisconsin Farm Bureau Federation.

I am like thousands of dairy farmers in Wisconsin who are faced with the decision of modernizing/expanding my dairy operation or exiting the business in the next few years. I started farming in 1979, rented land and facilities until 1988, when I bought my current farm. In 1979 I was one of over 46,000 dairymen in the state of Wisconsin. Today, 20 years later, less than 23,000 dairy farmers remain. Wisconsin continues to lose about four dairies a day, or about 1500 a year. In other words, Wisconsin loses more dairy farmers in one year than most states have in total.

As I decide on how to update my dairy operation, issues such as land base, facilities, technology and financing are all issues that I must consider. One factor that should not be part of my planning is how federal dairy policy will impact my business. I am not a dairy policy expert, and if most are honest, few are.

After years of debate, today's dairy policy continues to be plagued by regional biases and politics. In 1996 Congress ordered Secretary Glickman and the USDA to reform and modernize the depression era Federal Milk Market Order System (FMMO). Farmers across the Midwest finally held out hope that the antiquated milk pricing systems would be scrapped and a new FMMO system would take into account today's technologies and transportation advances. When USDA reform hearings reached Wisconsin, over 500 dairy farmers attended, more than all other hearings combined. This is important, as FMMO reform has become more than a business issue, but also an emotional issue with dairy farmers across the Midwest.

Farmers have become apathetic and cynical as to whether reform can prevail over politics, and whether government has the ability to bring equity and fairness to the industry.

Last spring the USDA unveiled its long-awaited order reforms. We, here in Wisconsin, were not overjoyed by the modest reforms, but realized that they were a small, yet positive move toward a more market-oriented pricing structure. Throughout the previous year USDA heard opposition from southern and eastern states to the initial proposal, so USDA diluted its original modest reform to what eventually became the Final Rule on Federal Milk Market Order reform.

In the fall of 1999 farmers and cooperatives across the country voted on the reform package, and by an overwhelming vote accepted the Final Rule. At that time we were to see implementation of the final rule that would consolidate the number of marketing orders and would bring modest changes to the old Class 1 differentials that price milk using Eau Claire, Wisconsin, as the pricing basis point. We would also see the sunsetting of the price fixing scheme called the Northeast Dairy Compact. However, in November of this past year, regional politics prevailed.

Members of Congress took it upon themselves to overthrow USDA's final rule that had been voted on by farmers and their co-ops, and instead imposed their own reform that was little different than the system that Congress had originally ordered to be changed. In doing this, Congress totally disregarded farmers' rights when they mandated the new FMMO rules without allowing farmers the right to vote on these reforms as stipulated by USDA's own rules.

Where do we go from here?

First, I hope that you have the resolve to:

- help the dairy industry into the 21st century with an inclusive/comprehensive policy that knows no regional barriers;
- understand and accept that milk will be produced where it can be most economically produced, and where there is the infrastructure that can service, process and deliver the product;
- create a policy that will allow dairy farmers to profit because of their abilities, not because of where they live.

To achieve these goals, I believe that we need to have a policy that has a single, nation-wide Class 1 pricing structure (national pooling) and uniform rules that regulate the manufacturing industy (make allowances).

Only then will we be able to move beyond the regional price distortions, and the temptation of politicians to manipulate the system. If this cannot be accomplished, I think Congress should strongly consider total deregulation, a position that has been endorsed by the membership of the Wisconsin Farm Bureau Federation.

Members of the Committee, please let this hearing be the beginning to meaningful change. I trust, Mr. Chairman, that this hearing is genuine and not held just as a gesture to appease the Senators from the Upper Midwest.

Mr. Chairman, there are many challenges that need to be addressed that can help all farmers across the country:

- the need for Congress to continue to work on developing trade dialogue that fosters free, fair and open trade;

- the need to continue to examine tax reform issues that would include risk management strategies; and

- the need to address environmental regulatory issues that threaten every farmer today.

Mr. Chairman and Members of the Committee, thank you for the opportunity to come before you today.

Respectfully submitted by Richard Gorder

Associated Milk Producers Inc

315 N. Broadway, P.O. Box 455, New Ulm, MN 56073
Phone: 507-354-8295

Testimony of

Wayne Bok
Dairy Producer
Geddes, South Dakota
and
President, Associated Milk Producers Inc.

before the

Senate Committee on Agriculture, Nutrition, and Forestry

February 8, 2000

I want to thank you Chairman Lugar and other members of this committee, for allowing me to participate in the hearing.

I am Wayne Bok of Geddes, South Dakota. I own and operate a dairy farm in south central South Dakota, as well as serving as president of Associated Milk Producers Inc. AMPI is a Midwest dairy cooperative, representing 6,500 members in seven Midwest states.

Before driving to the airport yesterday, I helped milk cows. While I am gone, my sons will milk our herd of 80 Holsteins.

Statistics define my Midwest dairy as average. I define the dairy as the sum of all I have worked for the past 34 years.

When I began dairying, I milked 20 cows, using what is now considered antiquated equipment. Though milk prices fluctuated, there was always a strong support price. As a Midwest dairy farmer, I was milking in America's dairy land, marketing through our hometown cooperative. I wouldn't call my early years of milking the good ol' days, but it's important for you to know where I've been in this industry before discussing the future.

Today, I milk 80 cows and that is not enough to support two sons and their families. To add value to my milk, I am marketing through a dairy cooperative which moves dairy products up the marketing chain.

If the next generation of Boks wants to milk for another 30 years, we must invest in our family business. Before we invest in state-of-the-art dairy facilities and technology, we need state-of-the art dairy policy under which I can operate this multi-million dollar business.

You can't operate a 21st century dairy with depression-era dairy policy. This is not my father's dairy. I can't use my father's dairy policies.

U.S. dairy policy must catch up with the dairy industry. The scope and size of today's dairy farms and cooperatives illustrate my point. We are moving from regionally based dairying to the national and international scene. Today, I'm competing with dairy farmers on both U.S. borders for cheese, nonfat dry milk and butter markets. In coming years, I may be competing with dairy farmers on both sides of the ocean.

We face an environment of accelerated change caused by economic globalization, market volatility and intense competition. We need to leave regional mindsets and move to a national approach for dairying, marketing and policy.

The dairy policies passed by Congress last fall merely add another block to dairy's growing domestic barriers. Efforts to bring rational reform to dairy policies failed as regions of this country which benefit from the status quo continue to block those reforms.

Regionally based dairy policies such as federal milk marketing orders and dairy compacts are destructive. How can I compete internationally when I am not allowed to compete domestically?

In a country where California cheese can end up in a Minnesota cheese sauce plant or Iowa milk in a Florida milk carton, it makes no economic sense to build trade fences for milk – such as we've seen through regional dairy compacts. Isn't this the very reason our forefathers wanted a unified national economy?

As congressional leaders, you can tear down walls with nationally oriented dairy policies. When developing a policy, ask yourself: does this policy hinge on regional bias? If the answer is yes, then discard that idea.

Allow me to offer three ideas that work together to yield a program that helps every dairy farmer – no matter where he milks cows:

- Maintain a dairy price support system
- Protect domestic milk markets
- And manage our country's milk supply

We all know policy debates are driven by an economic backdrop. With mounting milk surpluses and subsequent low prices, our industry is quickly joining other agricultural commodities facing depressed prices.

We need to think outside of dairy's policy box.

Chairman Lugar and members of the Committee, dairying is big business. Since 1990, the size of the average dairy herd is up about 75 percent. Dairy farms are changing. Dairy cooperatives are changing. Markets are expanding. Dairy policy must adjust to this new environment.

If individual family farms commit hundreds of thousands, even millions of dollars, to an on-the-farm business, you need to adopt national dairy policies which support these efforts.

I urge this Congress to consider closely the words of Abraham Lincoln, who said, "A house divided against itself cannot stand." It's time to move beyond regionally discriminatory dairy policies that divide our nation's farmers and to work toward national policies that work for the nation as a whole.

Thank You.

Statement by Senator Charles E. Schumer
Dairy Hearing
February 8, 2000

I continue to believe in the necessity of the Dairy Compact for the Northeast as well as anywhere else farmers are in need of decent commodity prices in order to stay in business. The intention of these Compacts is to ensure dairy farmers a minimum price for their products and to help farm families remain healthy and strong in this era of low farm prices.

New York dairy farmers' incomes are currently at their lowest levels since 1978 and 1,500 New York dairy farms have been forced out of business since November 1997, due largely to wide fluctuations in the price of milk.

The purpose of the Dairy Compact is to stabilize farmers' income and enable them to budget accurately and plan for the future. Farmers must have stable prices in order to manage their business and stay afloat.

Compacts do not cause drastic price increases or overproduction of milk. In New England, the price of milk under the Compact has never been more than 4 cents higher than the national average, an increase of about $3.20 - $4 per family per year. In contrast, Florida, which does not have a Compact, has lost so many dairy farms that Floridians now pay up to 40 cents more per gallon of milk transported by truck from the Midwest.

Last year, Congress passed Option 1A, a nationwide milk pricing plan. Without the Option 1A program, New York farmers would have lost $30 million every year and its passage represents an important first step in supporting dairy farmers.

Our dairy farms are family businesses, and the very backbone of rural life in Upstate New York. The Dairy Compact is necessary to preserve a rapidly disappearing way of life.

Mr. HELMS: Mr. Chairman, I appreciate your scheduling this hearing to examine federal policy toward the dairy industry. I am proud of North Carolina's dairy farmers and manufacturers, who are of great importance to the agribusiness economy of my home state, and I am keenly interested in hearing from the assembled witnesses.

I am persuaded that the establishment of a Southern Dairy Compact would save the dairy farmers and manufacturers, who are facing a combination of market factors that threaten their livelihood. In 1985, there were more than 1,100 grade A dairies in North Carolina. Today, there are fewer than 500. In fact, every southern state is experiencing a precipitous decline in dairies.

Inasmuch as milk is a perishable product and transportation costs are passed on to the consumer, it is of no benefit to the consumer when milk must be imported in order to meet demand. The more local fresh milk available, the better off consumers and our rural economies will be.

The demonstrable success of the Northeastern Dairy Compact indicates that our dairy industry's problems are not insolvable — but only if Congress allows the Southern Dairy Compact to move forward. The Northeastern Dairy Compact has stabilized the huge price swings for fluid milk, thereby keeping more family farmers in business. Best of all, compacts operate at no net cost to the federal government.

Mr. Chairman, I will be grateful if you would include in the record of this hearing a letter from the Honorable Jim Graham, the longtime Commissioner of Agriculture in the State of North Carolina. Incidentally, Commissioner Graham is retiring at the end of the year after a lifetime of public service, and he will certainly be missed by the agriculture community. I know how highly respected he is within the dairy industry — and by the members of this Committee — and I will greatly appreciate your including his thoughts regarding this important issue.

Jesse Helms

STATEMENT OF
U.S. SENATOR JOHN BREAUX
BEFORE THE
SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
FOR THE COMMITTEE'S HEARING ON DAIRY POLICY
FEBRUARY 8, 2000

Mr. Chairman, thank you for the opportunity to submit testimony for today's hearing. As importantly, thank you for holding these hearings on federal dairy policy.

For dairy producers in Louisiana, market price volatility and instability and soft fluid milk prices have been devastating over the years. For these reasons, they want and need a change in policy.

In 1996 and again last year, Congress revised dairy policy and needs to do so again this year. We need a policy which assures adequate supplies of safe, healthy and fresh fluid milk. We also need short and long term price stability and reliability. Just as we need affordable prices for consumers, we also need fair prices for our dairy producers.

In my testimony today, Mr. Chairman, I am testifying in strong support of Louisiana's dairy producers and their families and in strong support of a Southern Dairy Compact.

The Northeast Dairy Compact, comprised of six New England states, is now federal law. It is operating successfully, I'm told. It also has withstood federal court challenges to date, as I understand. Last year, Congress extended the Northeast Compact until September 30, 2001.

The Northeast Compact, including the two-year extension granted last year, is part of the course of change in dairy policy which Congress has taken in recent years.

Much credit and praise go to Vermont's two Senators, Senator Leahy and Senator Jeffords, for their dedication and persistence in getting the Northeast Compact ratified in 1996 and extended last year.

I am a cosponsor of S. J . Res. 22, introduced by Senator Jeffords last year, which has been cosponsored by nearly 40 Senators. The bill is a joint resolution which calls for consent to be granted for the Northeast Compact, which now has been addressed by Congress, and also calls for Congressional consent for a Southern Dairy Compact, which I hope will be ratified this year.

Louisiana's dairy producers and the state's dairy leadership, including our Commissioner of Agriculture and Forestry, the Honorable Bob Odom, have been in the forefront of the movement to ratify a Southern Compact.

Louisiana's legislature has passed and Governor Mike Foster has signed a state dairy compact bill into law.

A number of other states have passed their own state-level dairy compact laws in support of a Southern Dairy Compact. These states include Alabama, Arkansas, Georgia, Kansas, Kentucky, Mississippi, Missouri, North Carolina, Oklahoma, South Carolina, Tennessee, Virginia and West Virginia.

Louisiana is a deficit state in terms of its fluid milk production. Our hard-working dairy families are doing an outstanding job of producing fluid milk locally for our state's citizens, but we have a shortfall in production relative to demand.

Louisiana, in 1999, had 475 dairy producers, down from 493 in 1998, or a decline of almost 4 percent in one year. The 1999 number is down from 646 in 1995, or a decline of approximately 26 percent. One of my strong concerns is that Louisiana continues to lose dairy families. As we lose those families and don't make up their production with the remaining producers, the state's milk supply deficit increases. As our local production declines, we have to transport more fresh milk in from other states to supply our residents. If we have to start going farther to acquire adequate supplies to offset a growing in-state deficit, the greater the challenge will be to supply fresh, safe and healthy fluid milk.

As painful as the loss of dairy families is, it is also painful to know that those losses affect their communities and the local and state economies.

Louisiana's industry believes it needs an interstate compact to help it try to survive. The industry appreciates very much the 1999 Congressional mandate for USDA to implement Milk Marketing Order Option 1-A. But, the industry also emphasizes strongly that the Southern Compact is the other anchor it needs to help bring stability, reliability and fairness to their fluid milk markets and prices.

Louisiana's industry believes that a Southern Dairy Compact is a much-needed and deserved change in federal dairy policy. They believe that is the course to follow. They want to see it ratified by Congress and signed into law as soon as possible this year.

I strongly support my state's dairy producers and their families in seeking the Southern Compact's ratification and will continue working with them.

Louisiana's dairy families work very hard to stay in business. We benefit from their year-round daily enterprise with locally-produced fresh, safe and healthy fluid milk. Their communities also benefit economically. These producers and their families deserve market place stability and reliability and fair milk prices.

Mr. Chairman, we have several key factors in place to justify a Southern Dairy Compact:

(1) the ratification and successful record of the Northeast Dairy Compact;

(2) the 1999 Congressional extension of the Northeast Compact for two years;

(3) 14 states approving state-level dairy compact bills and supporting Congressional ratification of a Southern Compact;

(4) a continuing decline in dairy families due to marketplace instability and reliability and a need for fair milk prices;

(5) nearly 40 Senate cosponsors in support of S.J. Res. 22.

In closing, I urge the committee to support passage of Congressional legislation to ratify a Southern Dairy Compact this year and its enactment. I commend you for holding these hearings on dairy policy and thank you for the opportunity to submit testimony.

DOCUMENTS SUBMITTED FOR THE RECORD

FEBRUARY 8, 2000

American Association of
Grain Inspection & Weighing
Agencies

Executive Director
Paul S. Weller, Jr.
1629 K Street, N.W., Suite 1100
Washington, D.C. 20006
(202) 785-6740
FAX (202) 331-4212
email AgriWash@aol.com

STATEMENT
OF THE
AMERICAN ASSOCIATION OF GRAIN INSPECTION & WEIGHING AGENCIES
BEFORE THE
SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY
ON THE RE-AUTHORIZATION OF THE
GRAIN INSPECTION, PACKERS & STOCKYARDS ADMINISTRATION
FEBRUARY 8, 2000

The American Association of Grain Inspection and Weighing Agencies (AAGIWA) is the national professional association representing the public and private agencies that are designated and delegated by USDA's Grain Inspection, Packers & Stockyards Administration (GIPSA) to weigh, inspect, and grade the nation's domestic grain. Its member agencies are located throughout the major grain-producing regions of the U.S., and represent the majority of all official domestic inspections performed under the U.S. Grain Standards Act.

AAGIWA member agencies bring a professional and disinterested aspect to the grading and weighing of America's grain. During the association's 40-plus years of service to the industry, it has assisted its members in performing these services through a national forum that promotes and assists professionalism, technology, and performance, while providing a constant dialogue with government and industry.

AAGIWA wishes to comment on the pending re-authorization of GIPSA beyond its current September 30, 2000 statutory expiration date. In doing so, the association wishes to support Congressional re-authorization of the agency, and wishes to provide the following observations to the Congress:

Role of GIPSA -- There is an important role for a federal regulatory and supervisory agency in the operation of an official grain inspection system. GIPSA serves to provide an objective, third party regulatory role, which assures credibility and integrity for both domestic and foreign grain handlers and buyers of U.S. grain. Its strict federal standards help maintain the accuracy and consistency that the grain industry has come to expect from the nation's official grain inspection system.

GIPSA's Past and Present Record -- AAGIWA commends GIPSA for its current record of flexibility and availability to the suggestions and recommendations of its constituency. It has kept an open mind to change, and made changes when costs and benefits were analyzed and found productive. This association views GIPSA as an essential partner in official inspection agencies' efforts to promote and facilitate the movement and trading of the nation's grain. The assurance of integrity that GIPSA lends to the official grain inspection system is vital to the system's continued existence. As more concerns are brought forward by domestic users and foreign buyers of U.S. grain, GIPSA and its designated and delegated official agencies stand ready together to meet those challenges.

Mandate for Change—AAGIWA believes that GIPSA's role in the grain industry must keep pace with the fast-changing needs of its customers; that it must anticipate and react quickly to new trends and technology; and that it must become more efficient and effective as the primary monitor of the U.S. Grain Standards Act. Toward that end, AAGIWA calls on Congress to consider the following improvements to the official grain inspection system, as it re-authorizes GIPSA:

• **Extend the designation period for official agencies –**
Official agencies currently must be re-designated every three years, requiring extensive on-site federal evaluation and investigative manpower and resources. This designation period should be extended to five years or more, with GIPSA maintaining its traditional role of closely monitoring and evaluating official agencies' performance. GIPSA expends extensive resources in its constant and frequent re-designation and re-delegation of official agencies, resources that could be better expended in promoting and assuring an improved and customer-responsive official grain inspection system.

• **Establish a central grain monitoring system –**
GIPSA currently performs quality checks and re-inspections at its many regional field offices, resulting in a duplication of staff and resources, and a lack of consistency of results. A central monitoring laboratory or system should be established by GIPSA, so that check tests and inspection results are strictly standardized and consistent under the professional auspices of one inspection team. We believe that such consolidation would decrease regional and inter-market grading differences, eliminate duplication of staff, equipment, and office space, and allow the national system to respond more rapidly to grading problems and customer concerns. With current video imaging technologies, much of the consolidation could be accomplished in "virtual" space, without the need for additional investments in brick and mortar.

• **Provide financial support for the Official System -**
Official grain inspection agencies have contributed millions of dollars through agency supervisory fees to GIPSA. These fees have been deposited in an Official Agency Trust Fund, which currently contains more than $4.7 million of unallocated reserves. We believe that a portion of these unallocated funds should be invested by GIPSA to improve the official grain inspection system and make it more competitive, by making available new technologies available for official agency use, bringing about consolidation of the system's services, and promoting and marketing official grain inspection and weighing services. The dividends alone from these reserves would go a long way toward improving the system and its outreach.

• **Assign GIPSA a marketing/promotion role -**
The nation's official grain inspection system continues to lose ground to unofficial and industry in house inspections. More customer education is needed on the beneficial aspects of official inspection services. This education should be done on a coordinated national basis, preferably through GIPSA as the federal parent agency. We believe that GIPSA should expand its agency efforts to market and promote the grain industry's domestic use of official inspection services.

• **Develop and implement a national on-line database** -- It is imperative that GIPSA take the lead in developing and implementing a national on-line, at-line certification and billing program. Currently, each official agency must develop its own system, at the expense of uniformity, continuity, and efficiency, to capture and disseminate the same type of inspection data. In the interest of customer service and efficiency of operation, GIPSA should take the leadership in developing an electronic system that could include the use of bar codes, electronic signatures, password protection for customer data, and digital interfaces to all electronic laboratory equipment.

This would make all official agencies equal and uniform in their customer services, improve the accuracy of inspection data, provide instant access to pertinent industry data, and eliminate duplication of factors onto pan tickets, certificates, and billing. Cost of such a beneficial and uniform system could be borne largely from available trust fund moneys.

Summary -- In conclusion, AAGIWA commends GIPSA for making changes for the betterment of the official grain inspection system, for its integrity, and for its beneficial partnership with the 60 state and private agencies that perform official duties at the local level. As Congress moves to re-authorize this federal agency, it is important that new technologies and efficiencies be brought to bear as soon as possible, and that the above-stated fine-tuning be implemented in order to assure the future strength and viability of this valuable national industry system.

\# # # #

Bob ST for record

State of North Carolina
Department of Agriculture
Raleigh

JAMES A. GRAHAM
COMMISSIONER

February 4, 2000

The Honorable Richard Lugar
Chairman of U.S. Senate Agriculture, Nutrition, & Forestry Committee
328A Senate Russell Office Building
Washington, D.C. 20510

Dear Senator Richard Lugar,

Agriculture is and always will be my life. I have served as North Carolina Commissioner of Agriculture since 1964. Throughout my tenure as Commissioner, I have never seen the amount of economic stress and difficulties being shouldered by our Agribusiness Community. All branches of government and the public need to take immediate action if we are going preserve the great agricultural heritage of our Nation.

I want to thank you for allowing agriculture to voice our opinions concerning the marketing of our dairy products before your committee. Our state's dairy industry may not be the leading commodity in North Carolina, but it is still vital to our agribusiness economy and influences almost every household in our state by the consumption of its products. Our state currently has approximately 450 dairy farms with an estimated 73,000 cows producing over 1.25 billion lbs. or 145 million gallons of raw milk. Over 80% of this milk goes directly into fluid milk or Class I milk for public consumption. It is estimated that the citizens of North Carolina consume more than 195 million gallons of fluid milk per year. As you can see, we are a deficit state in milk production.

It would appear because of this deficit, that the market would dictate higher market value for locally produced milk. However, an imposing scenario has developed over time. First, the milk produced in our state is priced in a direct correlation with the value of cheese and powder. Our state's production overwhelmingly goes into fluid milk. Second, our producers are penalized in the marketplace by having to pay give-up charges and transportation expenditures associated with milk being imported to our state from cheese and powder production areas. This action is required our dairy producer groups to fill supply contracts granted from the local processing plants.

As a state and region, our dairy industry does not have the ability to address these marketing concerns. Therefore, it has become imperative that our states join with another 24 states in requesting permission from Congress to form dairy compacts. I believe that formation of a regional dairy compact is the only viable means for our dairy industry to survive and for the citizens of North Carolina to be assured of a reasonable supply of fresh and wholesome milk. Not only do I believe it but so does the state legislatures and governors in 25 states. In North Carolina, we had all of our senators and representatives to vote in favor our state joining a Southern Dairy Compact with the exception of one. Across all the states requesting permission to join a dairy compact, the voting has been 5,405 to 316 in favor or a ratio of better than 17 to 1.

From statistics associated with the Northeast Dairy Compact, economic figures indicate a decrease in volatile swings in the marketplace at the producer level with little or no effect on the retail price for milk. The dairy compact also budgets to protect domestic nutritional programs such as WIC and school milk programs. Moreover, the most amazing thing is that a dairy compact is economically self-supporting and requires no funding from government.

I encourage your committee and your fellow constituents to consider and approve the right for states to work together to resolve their agricultural problems. Congressional approval of a Southern Dairy Compact and the expansion of the Northeast Dairy Compact would be a tremendous step in the right direction.

Respectfully,

Jim Graham

James A. Graham
Commissioner

cc: Senator Jesse Helms
Senator John Edwards

FARM BUREAU NEW YORK

New York Farm Bureau • Route 9W, P.O. Box 992 • Glenmont, New York 12077-0992 • (518) 436-8495 Fax: (518) 431-5656

February 7, 2000

The Honorable Richard G. Lugar, Chairman
U.S. Senate Agriculture Committee
Senate Hart Building
2nd & C Streets, NE, Room 306
Washington, D.C. 20510

Dear Chairman Lugar, Senator Harkin and Esteemed Members of the Senate Agriculture Committee,

Thank you for convening a Senate Agriculture Committee hearing to examine dairy pricing and policy.

New York Farm Bureau is a membership organization of over 30,000 member families. As New York is the nation's third largest dairy state, a significant portion of our members are dairy farmers. On behalf of our dairy farm families, I would like to offer a few comments on recent trends in New York State dairying, our one month experience with the newly consolidated Northeast Order, and our organization's strong support for New York's inclusion into the Northeast Interstate Dairy Compact.

Over the past ten years, New York's dairy industry has changed considerably. A quick glance at the New York Agricultural Statistics Service dairy industry survey demonstrates that our state has lost 4,122 dairy farms in the past ten years. During that same time, our milk production, while not bounding ahead like the south western states, has slowly but steadily increased. At the same time our average number of cows has declined, but our production per cow has dramatically increased, from 14,413 to 16,748 (pounds per year). While I suspect that these statistics are not entirely dissimilar to other dairy states, we have found that while our farm numbers keep declining, the farms we retain are expanding, purchasing farms from their neighbors, and increasing production. However, unlike states such as California, Idaho and New Mexico, New York still has a relatively small average dairy herd size of 100 cows. The strength of our dairy industry translates into a ranking among states as third in the production of corn for silage.

Our processing industry has changed as well. Over the past 10 years New York has lost 23 pasteurizing dairy plants, and 6 manufacturing dairy plants, for a total of 89 remaining dairy plants in New York. Our fluid milk sales in New York State have declined for whole and low fat milk, but have increased for skim. New York ranks first in the nation for the production of cottage cheese, third for the production of Italian and total cheese (excluding cottage).

While it is early to be evaluating the effects of the new federal order system, I thought I would briefly comment on New York's inclusion into the newly consolidated Northeast Order 1. Most of New York, with the exception of a portion of western New York, is incorporated into the new order 1. Our amount of milk pooled per month has increased, as has our fluid utilization rates, which is certainly good news for New York's producers. The enactment of Option 1A has meant that our farm families will not lose an estimated $8,000 per year in income, which during a year of low milk prices would have resulted in a significant increase in the number of farms lost to production. While we have not yet seen its effect in our milk checks, the usage of either the higher of Class III or Class IV price as the base price for Class I will also assist our producers by boosting their checks after the low December Class III price of $9.63.

New York Farm Bureau has for several years supported the inclusion of New York into the Northeast Interstate Dairy Compact. The idea for the Compact actually originated in New York well over ten years ago, with our state Legislature's former Legislative Commission on Dairy Industry Development. Consumers have proven to be supportive of this new price stabilizer to preserve and bolster their respective state's dairy industries, as well as the bordering states. The concept of allowing farmers to regionally price fluid milk has stood the constitutional tests of our nation's court system, and almost more importantly, after over three years in operation, has passed the operational test with flying colors. The Compact Commission has proved to be a workable organization, returning a considerable amount of money directly to the farm during periods of low milk prices. While the question of whether compact producers are increasing milk production has long been contentious, the key point to remember is that during the same time that the Compact area was increasing production, so were New York and Pennsylvania dairy farmers. The disparity in Compact area production to the rest of the nation arose strictly because of a natural weather disaster in the largest dairy state of California.

It is to New York's detriment that we have well over 1,000 dairy farmers shipping milk into the Compact market but cannot allow all of our farmers access to the same Compact benefits. The difficulty of being a border state is even more pronounced now that we are sharing the same pooling system as our neighbors in the Compact region. It is illogical that states in the same federal order cannot participate in the same pricing structure, and New York and the surrounding states are clearly part of the same milkshed as the Compact region.

As you know, milk prices paid to farmers over the next several months are expected to remain depressingly low. In fact, just this past week the cheese price, at $1.11, almost hit the CCC support price of $1.10. The Compact was created to even out these drastic declines in milk price to help preserve our state's dairy industry. New York Farm Bureau worked extremely hard to convince our state Legislature to enact authorizing legislation so that our state may join the Compact, and continues to work with our state Congressional delegation to support the re-authorization and expansion of the Compact.

Again, on behalf of our state's 8,268 dairy farmers, I would like to thank you for convening hearings on dairy policy. Both as a dairy farmer and as President of New York Farm Bureau, I would respectfully urge you to allow New York and the surrounding states in the Northeast Order to become part of the Northeast Interstate Dairy Compact.

Sincerely,

John W. Lincoln

John W. Lincoln, President
New York Farm Bureau

National Grange
of THE ORDER of PATRONS of HUSBANDRY
A New Century - A New Grange

February 15, 2000

Sen. Richard Lugar, Chairman
U.S. Senate Committee on Agriculture, Nutrition and Forestry
SR-328A Russell Senate Office Building
Washington, DC. 20510-6000

Testimony by the National Grange Regarding Current U.S. Dairy Policy
And the U.S. Dairy Pricing System
Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry
February 8 & 9, 2000

Senator Lugar and Members of the Committee:

Introduction

The National Grange is this nation's oldest general farm and rural public interest organization. Founded in 1867, today the National Grange represents nearly 300,000 members affiliated with 3,600 local Grange chapters in 37 states. The National Grange is extremely concerned with the nation's current dairy policy. Today too many hard working family dairy farmers are being forced to exit the industry. Too many consumers are at risk to lose the benefits of fresh, locally produced milk. Comprehensive dairy reform legislation, including expanded authorization for regional interstate dairy compacts, has been one of the highest priorities of the National Grange for many years. The modest steps taken by Congress last year to address the current crisis in our nation's dairy industry have given us time to revisit these issues again this year.

The National Grange commends the Committee on Agriculture and Chairman Lugar for holding hearings soon after the start of the current session of Congress. Hopefully, these hearings can be the catalyst for immediate congressional action to further reform our nation's dairy policy. It now appears to the National Grange that if nothing is done to correct the current situation in the dairy industry that both dairy farmers and consumers will be the ultimate victims of Congress's failure to enact common sense and proven reforms to enhance the reliability, profitability and competitiveness of our nation's dairy industry.

1616 H Street, N.W., Washington, D.C., 20006-4999 • (202) 628-3507 • FAX: (202) 347-1091

Review of Last Years Key Dairy Reforms

Last November, after several long months of legislative battles, Congress finally passed modest dairy legislation that will assist many financially pressed dairy farmers and extend the rights of consumers to purchase fresh, locally produced milk and dairy products. However the final legislation fell short of the comprehensive dairy policy reforms that have been championed in recent years by the National Grange.

Highlighting Congress's actions on dairy policy in November was a two-year extension for the Northeast Interstate Dairy Compact. Since enactment of the Dairy Compact as part of the 1996 farm bill, prices for fluid milk in the New England region have been stable, consumers have benefited from a reliable supply of locally produced fluid milk, and food assistance programs, such as WIC and school lunch programs, have been unaffected. Currently, the Northeast Dairy Compact only covers Vermont, Maine, New Hampshire, Massachusetts, Connecticut and Rhode Island.

To the disappointment of the National Grange, the final legislation contained no authority to expand the Northeast Dairy Compact to other states in the Northeast region. New York, Pennsylvania, Maryland, Delaware and New Jersey have all voted to join the Northeast Dairy Compact and extend the benefits of this successful program to their consumers and farmers. However without specific authorization from Congress, these states may not participate in the Northeast Dairy Compact. *Expansion of the Northeast Dairy compact in the year 2000 to other states in the Northeast that have already voted to join this program is a top priority of the National Grange.*

A similar Southeast Interstate Dairy Compact is desperately needed as well. In the Southeast, the number of dairy farms is in serious danger of falling below the minimum numbers needed to support the service and commercial infrastructure of modern, efficient dairy farming. If that happens, not only will dairy farms in this region become unprofitable but also consumers in those states will permanently lose the ability to purchase fresh, locally produced milk. Nearly all of the eligible states in the Southeast region have already voted to create and join a Southeast Dairy Compact. But as in the Northeast, Congress has so far failed to pass the necessary authorization to create a Southeast Dairy Compact. *Creation of a new Southeast Dairy Compact will also be a top priority of the National Grange in the year 2000.*

Congressional action in November wisely instituted the milk pricing formula know as Option 1-A in the Federal Milk Marketing Order program to replace the USDA's modified Option 1-B formula. If Option 1-B had been allowed to take effect, dairy farmers across the nation would have seen their income reduced by an aggregate of $147 million annually compared to Option 1-A. *The National Grange strongly supports the continued use of the Option 1-A pricing formula under the federal milk marketing order program.*

The final legislation also extended the federal price support program for dairy products until January 1, 2001. The federal price support is the minimum price level that is set by the federal government to purchase processed dairy products such as cheese, butter or non-fat dry milk. The support price acts as a minimum price for dairy products. If commercial prices for processed dairy products fall below the federal minimum, the federal government will directly purchase dairy products from the open market at the support price until the commercial price rises to meet or exceed the federal support price. Without an extension of the federal dairy price support program, prices for processed dairy products, and therefore prices received by farmers, could fall even further below their currently depressed levels in the open market

Currently the federal price support level is $9.90 per hundredweight. This price level is below the cost of production for the vast majority of dairy farmers operating today. *Policy adopted at the 133rd National Grange convention last November calls on Congress to increase the federal dairy price support level to more accurately reflect the farmers' costs of production.*

The laws governing the specific prices paid to farmers for different types of processed dairy products was also amended by Congress to more accurately reflect their true farm value. Under the federal marketing order system, the prices paid to farmers for their milk are supposed to reflect the composite market value of the different dairy products that are purchased by consumers in that region. In the past, the procedures used by USDA to determine the market value of certain types of processed dairy products (known as Class III milk) did not always reflect their actual prices. This resulted in farmers being under paid. Now, Congress has given USDA until January1, 2001 to revise its regulations for determining accurate market prices for Class III milk, including a provision for concerned members of the public to question USDA's pricing formulas and suggest alternative pricing formulas that better reflect true market values for Class III milk. *The Committee on Agriculture should aggressively exercise its oversight authority over the USDA to assure that these changes are implemented fairly and on schedule.*

Congress also adopted an innovative pilot program last November that will allow farmers to enter into forward pricing contracts for their milk production. Forward pricing will allow dairy farmers to enter into contracts that set specific prices for their milk production with processors over an extended length of time. Dairy farmers who agree to forward pricing would receive the prices negotiated in their contracts with their processor, rather than the prices determined by federal milk marketing orders or other market prices. Forward pricing programs attempt to reflect the market value for a farmer's dairy production over an extended length of time, rather than the value of the production in the immediate, month to month time period that is commonly used today in most government dairy programs. *The National Grange supports the use of dairy forward pricing contracts under the pilot program and urges the Committee on Agriculture to use its oversight authority over USDA to assure that this program is implemented in a manner that will allow small, family sized dairy farms adequate opportunity to participate in, and benefit from, this program.*

Congress also allocated $125 million for USDA to distribute to dairy farmers as compensation for economic difficulties facing the industry. USDA has recently announced that it will distribute these funds on a targeted basis that favors smaller family sized dairy farms. *The National Grange strongly supports the decision by USDA to distribute economic compensation funds allocated by Congress in a targeted manner that confers the majority of benefit from these funds for small, family sized dairy farms.*

Further Reforms are Necessary to Restore our Nation's Dairy Industry to Financial Health

In 1985, the National Grange became the first national farm organization to advocate for the adoption of regional dairy programs. I know how difficult it is to enact this type of legislation, but as a Vermonter, I have also seen first hand, the benefits that the current Northeast Dairy compact provides to both dairy farmers and consumers. This successful program deserves to be permanently reauthorized and expanded to include the other states in the Northeast region that have adopted state law authorizing those states to join the Northeast Compact. The failure to expand this program will result in an unnecessary and devastating exodus of family dairy farmers from the Northeast region of the country. This exodus will take with them an irreplaceable expertise in the efficient production of milk and a commitment to agricultural resource management that results in not only the highest quality dairy products for local consumers but a unique and valued way of life for many communities.

A similar Southeast Interstate Dairy Compact is desperately needed as well. In the Southeast, the number of dairy farms is in serious danger of falling below the minimum numbers needed to support the service and commercial infrastructure of modern, efficient dairy farming. If that happens, not only will dairy farms in this region become unprofitable but also consumers in those states will permanently lose the ability to purchase fresh, locally produced milk.

While we have made some progress in implementing rational pricing formulas for fluid milk with the reauthorization of the Northeast Interstate Dairy Compact, consolidation of the Federal Milk Marketing Orders from 31 orders to 11, and the adoptions of the Option 1A Class I differentials pricing formula for the Federal Milk Marketing Orders, those collective gains only cover a portion of the average milk check. Most of the milk produced today does not find its way to the fluid market but instead moves to the market for manufactured dairy products. Today, nationwide prices for manufacturing grades of milk (used for cheeses, butter and non-fat powered milk) are falling to their lowest point in more than a decade. The federal support price for manufacturing grade dairy products is $9.90 per hundredweight. This price is below the cost of production for the majority of family dairy farmers to be able to produce milk at a profit. Congress should reauthorize and raise the federal support price for manufacturing grade dairy products to allow dairy farmers to meet their costs of production.

Conclusion-National Grange Dairy Reform Goals for the Year 2000

As outlined above, clear progress has been made to reform our nation's dairy program to make that program more sensitive to the needs of family farmers and consumers. However, several significant reform steps still need to be taken to return economic prosperity to the dairy industry and assure the survival of our nation's family sized dairy farms. To address the remaining concerns I have outlined here, the National Grange has adopted a three-point action plan for further sensible dairy policy reform this year. Those points are:

1. Support the permanent authorization of the Northeast Dairy Compact and the expansion of the Northeast Dairy Compact to include all other eligible states in the Northeast region.

2. Support the permanent authorization of a Southeast Dairy Compact to include all eligible states in the Southeast region.

3. Support an increase in the minimum federal support price for manufacturing grade dairy products.

The National Grange strongly urges the members of this Committee to support the enactment of legislation that incorporates these specific reforms during the current session of Congress.

In closing I would like to thank Chairman Lugar and the members of the Committee on Agriculture for taking time to consider the views of the National Grange on this important issue. I would appreciate these comments being made a part of the record for the Committee's hearings on dairy policy and dairy pricing held on February 8 & 9, 2000.

Sincerely,

Kermit W. Richardson, Master (President)
The National Grange of the Order of Patrons of Husbandry

Fred LaClair
18860 Woodard Road
Watertown, NY 13601
(315) 658-2302

Committee On Agriculture,
Nutrition and Forestry
Chairman Richard G. Lugar

Thank you for the opportunity to submit comments on the Federal Milk Marketing Order program. I'm a dairy farmer operating in upstate NY with seventy milk cows. I entered the dairy business on Feb. 11, 1955 with 21 cows and have witnessed enormous changes effecting the industry since that date.

For reasons unexplained, the Federal Milk Marketing Order program has failed in it's intent to help prevent marketplace behavior that would erode prices of farmer milk, as evidenced by the exodus of 94. 5% of producers in order #2 since 1959, down from 50,031 to the present 9,102. Among other things, east, west, north, and south has no relevancy in determining milk prices or Order policy. I can compete with any of my fellow farmers in any state, but I cannot compete with the Federal Government that sets policy that favors corporate industry and consumers. For a government of the people to lay the burden, of subsidizing the indigent of it's populace, upon it's ag producers by low pricing, is wrong and immoral, because, among other things, in the interim the rich are also subsidized. To view production agriculture strictly as a service for other parties benefit, especially as a nonprofit service, is also wrong.

Milk producers are constantly being confused by inaccurate reports on market conditions. The milk manufacturing industry reports there is an over supply of milk, but the Federal Milk Marketing Administrator reports supply is below commercial use. The latest issue of the Market Administrators report shows an estimated deficit of nearly 3 billion lbs. of milk for the 1999-2000 year. Although the Market Administrator was unable to supply the amount of production for the 1998-1999 fiscal year, he was able to supply the production for the calendar year 1999, which also showed a deficit. With that style of information, producers will always be at a disadvantage. The solution would be a supply management board that has access too timely and accurate market conditions.

There are some myths being circulated that should be dispelled and one of them is that dairy farmers increase milk production when prices are higher. The fact is, farmers produce more when prices are low because of the need to maintain an adequate cash flow. The volatile market, carefully calculated or not, is the cause. Another myth is that bigger is better. The fact is, studies have shown that not to be the case. In view of that however, some expansions are developed for no other reason than desire.

When farmers complain about the poor economical conditions that are forced upon them, the response, they chose the occupation, usually surfaces. The answer to anyone that would make such a statement is, most everyone chooses the occupation they engage in. In respect to someone's chose of an occupation does not infer that the earnings they receive will not keep pace with inflation and their worth. Some people have the privilege of union negotiators to barter for higher earnings and others have the privilege of voting for higher earnings. If all peoples earnings were commensurate with ag producers prices there surely would be more complaining.

As I mentioned in beginning of my comments, I began farming with 21 milking cows, each cow had a name and all of the cows were considered part of the family. The animals feed was of natural grain and forages with no growth hormones or animal by-products added. The income from the milk production was considered my earnings. The income from a hundred laying hens was my wife's earning. The majority of the farmer wives today work off the farm, holding jobs that could otherwise be held by their urban cousins. There is a saying, if a farmer could have four or five wives he could continue farming. Today with seventy cows I maintain the same feeding practices as I did with the twenty-one. More and more American people are calling for that source of food for their use. The American people do not approve of factory farms.

Several people have stated that the west and northwest milk producers can produce milk cheaper than the east and northeast milk producers can and therefore the west and northwest consumers pay less for milk products. The results of a limited survey I conducted suggest otherwise.

Enclosed is the result of a survey on bottled milk and cheddar cheese prices in several states, plus the latest issue of order #2 Milk Marketing Bulletin.

FEDERAL DAIRY POLICY

WEDNESDAY, FEBRUARY 9, 2000

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The Committee met, pursuant to notice, at 9:07 a.m., in room 328A, Russell Senate Office Building, Hon. Richard G. Lugar, (Chairman of the Committee), presiding.

Present or submitting a statement: Senators Lugar, Santorum, Fitzgerald, Grassley, Grams (ex officio), Harkin, Leahy, Conrad, Daschle, and Lincoln.

OPENING STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN. This hearing of the Senate Agriculture Committee is called to order.

We appreciated all of the witnesses in our hearing yesterday. A number of statements were made by Senators preliminary to the hearing and during the hearing, which proceeded for about 4-hours, as you will recall. I have no idea or prediction of the duration of this hearing today, but it will be equally thorough in questioning the witnesses and trying to gain information.

The question has been asked, at least of the Chair—so let me try to express this informally—as to what will follow after the hearings. And I will consult, obviously, with our distinguished ranking member, Senator Harkin of Iowa. But I suspect that we will try at least some straw votes of members of the Committee as to their disposition.

Among issues that might be discussed are whether members favor the so-called Policy 1A or 1B with regard to dairy, one policy being a policy suggested—in fact, more than suggested—by the USDA last year and countermanded really by action of the Congress at the end of the session to go to the status quo or the so-called Policy 1B.

So having heard—and we will hear a lot more today—about both of these policies, we will ask whether members have a disposition to confirm, change course, or are so divided that no consensus appears to be possible.

Likewise, with regard to the compact issue, there are ways that we could proceed there. One would be to authorize more compacts, to confirm the status quo, that is, the New England situation, or to wind up the status quo, namely, the New England Dairy Compact. But that is clearly an issue that is before the Committee and that is suggested by these hearings and the friendly clash of personalities, States, and so forth that we heard yesterday.

There may be other constructive policies that arise quite apart from disposition of the status quo of the past and what have you, and some of these were suggested yesterday by constructive dairymen who are pointing out sophisticated ways in which people are trying to make a living in this business and could be assisted by the Congress, leaving aside these age-old quarrels. So a lot of us are much interested in that testimony. Hopefully we will have some more today.

But in lieu of an opening statement, I thought I would go into this monologue to try to at least bring everybody up to speed that there was a thought expressed here and there that the hearing yesterday and today were simply a gesture by this committee to alleviate the panic that ensued when the distinguished Democratic Leader and our Republican Leader were trying to get the Congress stopped last November. We found that very difficult given the number of people that wanted to discuss dairy, and we are prepared to do so for several more days.

So as a part of that situation, I was asked to come to the floor, make a statement that Senator Kohl in particular and other Senators from Wisconsin and Minnesota could hear and confirm and commend. And so these hearings we are holding promptly as a result of that, as a pledge to that.

But some have suggested, having done that, that is the end of the affair. Not necessarily. It is if the members of this committee want it to be, and although I stated yesterday candidly my own preferences—and I think they are known—they are not determinative.

So having said that, let me turn to the distinguished Democratic Leader who was here at 9 o'clock, let the record show, for this important hearing. Tom?

STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Well, Mr. Chairman, thank you for your leadership and for following up with the commitment that you made last year. I well remember those days and remember what a vital role you played in bringing the session to a successful completion.

These hearings are valuable, and as you say, your position or my position may not be determinative, but your position carries a lot of weight, and we are interested in pursuing the matter, as you indicated, and I think the manner with which you have outlined the way the Committee will address this issue is a very constructive one and one that I think we should all endorse.

I did not have the good fortunate to hear the hearing yesterday, but I also commend you for your endurance if it lasted 4-hours.

I am one who believes—and it is probably no surprise for any of us in my region of the country—that the system is outdated, it is archaic, and we do need to address the complex array of pricing mechanisms that we have based upon a system that was created generations ago. I am one who believes that it is time for a national system and that we can't intervene in the marketplace unnecessarily and in many cases unfairly.

I think the time has come for us to create that national framework that doesn't benefit one region or the other, that doesn't benefit larger producers at the expense of the small. I am very hopeful that these hearings, as constructive as they are, could lead, as you have indicated, perhaps to a third way, a way that would allow for compromise and a way that would accommodate the concerns of those in the Northeast and the South, but also recognize the unfairness of the status quo.

So I certainly pledge to work with you, and no one works in a more bipartisan and conciliatory manner than the Chairman does, and I look forward to a constructive way with which to resolve these matters, hopefully this year.

But, again, I thank you for the hearings.

The prepared statement of Senator Daschle can be found in the appendix on page 272.]

The CHAIRMAN. Well, thank you for those comments. I really appreciate that because, as we found yesterday, this is not a partisan issue. It became much more sectional or State by State. So those are the more difficult issues to find consensus, to find majorities.

We have three panels today: the first, administration witnesses, and then two panels, one that will review dairy pricing, and the third, do we have a need for a Federal dairy policy at all.

I will ask that in the instance of the administration witnesses—and they are Mr. Kenneth C. Clayton, Associate Administrator of the Agricultural Marketing Service of USDA, accompanied by Mr. Richard McKee, Deputy Administrator for Dairy Programs of the Agricultural Marketing Service—that you give a summary of your comments in

Ten-minutes or less, as the case may be, and we follow the procedure of 5-minutes for each Senator. If there are Senators who wish to be heard again, we will have another round with regard to each of the panels.

With the other panels, I am going to ask, since there is a large number of witnesses—and we are grateful that each has come, some from a long distance—that each has 5-minutes to summarize the comments.

Let me just make the statement in advance that all of the statements will be published in the record in full, so it won't be necessary for you to ask permission for that to happen. That will occur because we really want a very full record of prepared statements as well as the questions and answers.

So at this point I will ask you to proceed, Mr. Clayton. We are very pleased that you and Mr. McKee have come to initiate our second hearing.

STATEMENT OF KENNETH G. CLAYTON, ASSOCIATE ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, U.S. DEPARTMENT OF AGRICULTURE; ACCOMPANIED BY RICHARD M. MCKEE, DEPUTY ADMINISTRATOR FOR DAIRY PROGRAMS, AGRICULTURAL MARKETING SERVICE, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC.

Mr. CLAYTON. Well, thank you very much, Mr. Chairman, and good morning. It is indeed a pleasure for us to appear before you today. We certainly appreciate your invitation to participate in today's hearing.

Of course, yesterday Dr. Keith Collins, USDA's chief economist, testified and provide testimony describing the overall situation and outlook for the U.S. dairy sector and our dairy farmers. Dr. Collins also briefly touched on the role of the Federal Order Program within the larger constellation of dairy policy as well as some of the other actions which have been taken to support dairy farmers' incomes.

Today what I would like to do is to address the Federal Milk Marketing Order Program in a bit more detail. My remarks will briefly describe that program, steps we have taken to implement the 1996 farm bill mandate, and to briefly touch on some of the anticipated effects of Federal Order Program changes on producers and consumers of dairy products.

Let me start then with the Federal Milk Marketing Order Program and perhaps just a bit of perspective on that program. Basically, the Federal Order Program is intended to promote the orderly marketing of what clearly is a highly perishable product, namely, milk. The Federal Order Program I think does so by helping to prevent marketplace behavior that might otherwise erode the price of milk at the farm gate and ultimately drive producers out of business.

The significance of this protection, of course, depends on the relative bargaining positions of dairy farmers and those to whom they sell their milk, the number and size of processors who are selling milk or bidding for producers' milk, the market strength of cooperatives that are selling farmers' milk, and other factors come into play, I think, when assessing the respective bargaining positions of dairy farmers and processors.

Of course, under Federal orders, the proceeds from the sales of farmers' milk are pooled within a market area with an average price or value being returned to producers. The prices at which processors must account to that pool are based, of course, on the end value uses of milk. To allow pooling to work, a set of classified prices are established under the Federal Order Program. It is important, I think, to note that these are minimum prices that processors must pay for milk corresponding to its value in several end-product categories. It certainly is the case that from time to time, and depending on markets, we see premiums that are paid beyond these minimums.

Class I milk, as you heard yesterday and as you already know, is the milk which basically goes in the bottle. It is fluid milk. It earns the highest minimum price basically for a variety of supply and demand characteristics that I think tend to make fluid milk more valuable in the marketplace.

Class II products have somewhat lower minimum prices. Class II products are the so-called soft dairy products. They are manufactured, but still have a fairly high degree of perishability, things like ice cream, yogurt, and the like.

And then, of course, we have got Class III and Class IV manufactured dairy products, things like butter, dry milk products, and cheese, which tend to have the lowest minimum prices under the Federal order structure.

Importantly, I think, these products tend to be traded in a national market, and because they are more easily stored than fluid milk or soft dairy products, they serve really as the residual claimant for milk under the Federal Order Program, residual claimant for milk that is not going to be used in Class I or Class II products.

Basically it is these manufactured products or the prices of these manufactured products then which provide the basis upon which these differentials are added to arrive at prices for Class I and Class II products.

As already noted, producers selling milk under a Federal order receive a uniform or weighted average price, called the blend price, that reflects all the uses of milk in a given market area. Thus, under orders, all producers in that order area benefit from the higher price on milk that is marketed for fluid consumption. At the same time, all producers share in the lower prices for milk that is diverted to manufactured products.

Under this arrangement, equity is preserved with producers not needing to engage in behavior that may be contrary to their interests, such as bidding the price of their milk down to its manufacturing value, even though it may be used for fluid milk consumption. In the same vein, under Federal order pricing, handlers are not in a position to play producers off against each other and drive that price down. And as I noted earlier, the important caveat there, I think, is ultimately the importance of all this does hinge certainly on the respective bargaining power of farmers and those to whom they sell their milk.

Let me turn now quickly to the process that we undertook to meet the congressional mandate, the 1996 farm bill mandate. As you well know, Congress first directed the Department to reduce the number of milk marketing order areas—in essence, to redraw the geographic boundaries to reflect the larger marketing areas in which milk is now sold, distributed, and consumed. And, second, I think clearly Congress directed the Department to consider changes to the pricing structure which is utilized under the Federal Order Program. Both the system of classified prices was examined as well as relative levels of Class I prices within and between marketing order areas.

The Department's final decision, which was issued in March 1999, detailed the changes that the Department thought appropriate to the Federal milk order program. Basically, the program provided for 11 consolidated milk order areas, down from 31. It established a nationally coordinated Class I price structure that provided greater efficiencies in milk assembly and distribution, also established new methods for pricing milk that is used for manufacturing purposes, and made minor changes to the classification of milk provisions, as well as standardized a variety of provisions and definitions and terms that over the years had become somewhat dissimilar across orders, and this was an opportunity to true all that up.

In August 1999, referenda were conducted to determine producer approval of the revised Federal milk orders. Dairy farmers approved the 11 orders and a final rule to consolidate and revise the orders was issued on August 23, 1999, with the revised orders to become effective October 1, in compliance with legislative mandates, certainly.

A bit of history intervened, and by November 29th, the Consolidated Appropriations Act of 2000 was signed, which, of course, required that both the revised orders become effective on January 1, 2000, and also that those orders utilize the so-called Option 1A Class I differentials. The Act further directed the Secretary to establish a temporary forward contracting pilot program and to hold a hearing on Class III and Class IV milk pricing formulas. The Department does expect to issue a notice soon on the pilot program for forward contracting, and on the just past January 31st , the Department put out a notice inviting proposals to be considered at a hearing, which we would hope to hold late April, early May on the Class III and Class IV pricing issue.

Finally, of course, on January 1 of this year, the final rule was implemented, and the new order program began.

With that bit of chronology, let me quickly then turn to the expected impacts of these changes on dairy farmers, and on consumers in particular. More specifically, as requested, I will focus on the differences between the Department's final decision and milk orders with the so-called Option 1A Class I price differentials. And in the interest of time, I will just cite a few of the summary impacts contained in my written testimony.

For dairy farmers, the all-milk price across all Federal orders is expected to average less than 6-cents per hundredweight or about 0.4 of 1 percent higher under Option 1A compared to USDA's final decision, between 5-and 6-cents per hundredweight. Annual gross receipts, the total rack-up of receipts to producers across all Federal orders, are expected to average on the order of $107.7 million, or about 0.6 of 1-percent higher, with the Option 1A differentials than would have been the case in the Department's final decision.

In considering the impacts of milk order changes on consumers, we have assumed that all changes in fluid processor milk costs and wholesale manufactured dairy product costs are passed through immediately to the retail level without any changes in processor retail or wholesale retail margins. Those margins in the real world will move. Some of them are percentage-based, but for purposes of analysis, we have assumed an immediate and complete pass-through.

Accordingly, consumer expenditures on fluid milk products in all Federal market order areas combined are estimated to average $116.8 million per year higher under the Option 1A differentials than under the Department's final decision. This is an increase of about 1.5-percent, given average annual consumer expenditures of $7.6 billion on fluid milk products in Federal market order areas.

Average annual consumer expenditures on manufactured dairy products—the numbers I just cited were for fluid milk, the impact in terms of manufactured dairy products across all Federal market order areas—are estimated to decrease by about $9.1 million per year under the 1A differentials as compared to the Department's final decision. To put that in perspective, annual expenditures on manufactured dairy products at the consumer level total about $9.3 billion, so this decrease of $9.1 million in the cost of increased costs to manufactured products means for consumers about a 0.1-percent decrease in terms of prices paid for things like cheese and cottage cheese and yogurt and so forth.

Mr. Chairman, that concludes my statement. My colleague and I will be happy to answer any questions that you or the Committee might have. Thank you.

[The prepared statement of Mr. Clayton, can be found in the appendix on page 279]

The CHAIRMAN. Thank you very much, Mr. Clayton.

Let me ask you, first of all, about the referenda that were conducted last August. These were conducted by USDA, and were the voters dairy producers in each of the 11-districts? Or how were the votes arranged? And were there majorities in each of the 11-districts, if that was the demarcation line?

Mr. CLAYTON. Well, first, yes, the way that the vote actually works is order by order. So in order for the 11 orders to pass, that vote had to be a two-thirds super majority vote.

The CHAIRMAN. Two-thirds majority in each of the 11-districts.

Mr. CLAYTON. That is correct.

The CHAIRMAN. How much participation was there by dairy producers in that referendum? Was this actively advertised and most voted?

Mr. CLAYTON. Well, as to the advertising part, I can certainly speak to that. The Department itself took great pain to try to spread the word far and wide as to what was being voted on. Our market administrators, who were located, of course, outside Washington and throughout the country, have newsletters, have many, many meetings with producer groups, will go meet with co-ops or whoever it might be who is having a meeting. So a lot of effort was taken to advise producers as to what was at stake here.

The voting process under the Agricultural Marketing Agreement Act of 1937 that this program operates under, does provide for block voting by cooperatives. Therefore, depending on how a cooperative would choose to determine the sentiment of its producer members, that would have something to do with the role that each individual producer played.

There were some cases where milk pooled under an order was not associated with a cooperative. In those cases, individual ballots were provided.

The CHAIRMAN. That is interesting. The cooperatives voted and a few individuals.

Mr. CLAYTON. That is correct.

The CHAIRMAN. Essentially.

Mr. CLAYTON. Yes.

The CHAIRMAN. But, in any case, well over a two-thirds majority in each of the 11 situations.

Mr. CLAYTON. Yes, Sir.

The CHAIRMAN. You know, I thought this was the case, but I wanted to just simply in your own words obtain the case, because at least superficially it appeared that USDA's compliance with our farm bill of 1996 was accepted and supported by producers. Not everybody was pleased by this result because, as you pointed out, chronologically, by the time the Congress was concluding our activities on November 29th or thereabouts, what had been approved apparently by a two-thirds majority in 11 districts was abruptly disapproved, and we went back to something close to the status quo.

Describe from your standpoint, why was there opposition to what you had done? And how could this have been resolved? Or perhaps I am asking you to look into the vagaries of congressional activity as to what we might have done or might not have done. But something that appeared to be moving in this direction with this kind of approval, obviously it didn't happen. What is your analysis of where the opposition is, where the argument is?

Mr. CLAYTON. I probably would start, Mr. Chairman, by indicating I will not venture into the arena of suggesting what the Congress ought to think about on this. But having said that, certainly, as you point out, the votes that were taken were overwhelmingly in support.

I would have to note, in fairness, that the alternative to supporting it was elimination of the orders. So, clearly, by virtue of the record as it unfolded, as you point out, there were people who voted in favor but not necessarily were enthused about some of the content, at least.

Clearly, there is also, I think, as you pointed out in your opening remarks, there are great differences of view as to what the most appropriate pricing structure for dairy ought to be.

The CHAIRMAN. More particularly, it appeared, as I visited with dairymen around the country at that time, some said, well, we are going to lose a lot in this. And other said, well, we are going to gain modestly. But there were winners and losers. When you went from the 31 to the 11, despite the fact that the conglomerate majorities in each of the 11, within this there were some subgroups who said under the 31 we did better. So, presumably, they contacted their local Members of the House or their Senators and said, you know, you have got to sort of stick up for us, leaving aside whatever USDA was doing in these referenda. And in a democracy all these factors are brokered in.

But, in any event, as you know, I publicly commended USDA for work that you had done because it was consonant with what we had done in our farm bill. The dairy thing was the very last thing decided in the Congress.

But, for the moment, why, we are back to square one. And prior to Senator Lincoln and Senator Conrad coming in, in my dialogue with my colleague, Senator Daschle, I indicated that at some point in the near future we will ask committee members what their own views are with regard to 1A and 1B or some other, 1C or D or so forth, as to how we proceed. But that is why I wanted to elucidate these thoughts from yourself.

Now, you are making the comment, after all is said and done, however, and you have got down to 11-marketing-orders and simplified this thing, essentially you believe—well, stated another way, the action that Congress took to adopt the 1A, the status quo, resulted in about $107 million more revenue for dairymen and about $116 million more expense for consumers. That is sort of the nature of it, the 1-percent shift in terms of the volume of what is being done. Is that a fair characterization of the impact?

Mr. CLAYTON. Yes, I think it is, Mr. Chairman, and as you point out, obviously the money to be provided to dairy producers has to come from somewhere, and we are talking about basically the marketing of a product to consumers. Clearly, that money————

The CHAIRMAN. I would have to trace back, but it seemed to me Keith Collins yesterday intimated he had done some computations of all of this and has come to conclusion that dairymen would have been, say, $100 million better off with USDA's policy. It is hard to tell, I suspect. The markets fluctuate rapidly. You have to stipulate certain things happening.

Mr. CLAYTON. And the overall size of the market clearly is such that—not to minimize the importance of $100 million one way or the other, certainly that is a lot of money————

The CHAIRMAN. You are talking about a $9 billion market or something of that sort.

Let me turn to my colleagues, and we will try to have just 5-minute rounds of questioning. Senator Daschle, do you have a question?

Senator DASCHLE. Thank you, Mr. Chairman.

Mr. Clayton, you said in your opening comments that you had done an analysis of the impact that the 1A differential had on dairy farmers and consumers in various regions of the country. Did you do a similar study with regard to 1B and the administration proposal? And if so, could you share with us that study and the results?

Mr. CLAYTON. Yes, Sir. In fact, the final regulatory impact analysis, which was published at the same time as we published the Secretary's final decision, does include all of that analysis.

Senator DASCHLE. Could you just summarize it for us for the purposes of the hearing this morning, just briefly?

Mr. CLAYTON. Sure. From the standpoint of producers and receipts to producers over the 5-year period that was a part of the analysis, clearly the Option 1A was going to result in the highest level of receipts, relatively speaking. The final decision I guess would be next in line, and the Option 1B would have been the lower of the three alternatives which were examined in that impact analysis.

Clearly, the impact for consumers flips around and works just in the reverse. But answering that question is a little dangerous without getting into some of the detail, which I don't think we have time to do here this morning, but certainly one does need then also to look at implications in terms of fluid milk consumption—or let me step back, in terms of overall production levels of farm milk, of impacts in terms of fluid milk consumption, impacts in terms of the manufactured market. And those vary some across those three as well.

Senator DASCHLE. Well, I guess I still don't know if I have as clear an understanding of the difference by region. Could you elaborate more specifically with regard to regional impact and contrast the two based upon your analysis?

Mr. CLAYTON. Let me ask Mr. McKee, who dealt in some greater detail with the numbers—maybe he can help us with that. I don't want to be evasive here at all, but there are a lot of data.

Mr. MCKEE. There is an extreme amount of data available, and we did do it by regions. We selected 36-points, basically, and analyzed the impact of Option 1A, Option 1B, and the final decision.

We looked at each of these major primary population points, and as you can imagine, in about half of those areas you had income increases generated, in about half of those areas you had income decreases. And those depended largely upon the types of milk that are produced and consumed in those areas and largely, if you look at the map, there were winners and losers, as the Chairman indicated earlier. They are certainly outlined. If you have specific regions, we can certainly provide that detail, but————

Senator DASCHLE. Well, let's just take arbitrarily the Midwest region and the Northeast region. No particular reason why. I just————

[Laughter.]

Mr. MCKEE. Under the Option 1B, there would have been a decrease in the Northeast area, on a 6-year average on price per gallon of milk, of around 6- to 9-cents on average over the 6-years. In the upper Midwest, you would have had an increase of 2- to 3-cents.

Senator DASCHLE. In the interest of time, for the record if you could provide us with it, I would appreciate a summary of your analysis of the impact that the two plans have had. I mean, we can work through the minutia of the data as well, but it would be helpful—the data itself isn't as useful as your analysis of the data, and I think if you could give it to us in summary form within a few days, that would be very helpful. I would like to see that. I am not sure that we can fully understand the numbers, but you can and you can articulate them in a way that would give us a far better appreciation of a good comparison between the plans. And I would like that, and I am sure some of my colleagues would as well.

Mr. CLAYTON. Mr. Daschle, if I could, just for clarity, are we talking Option 1B or the Department's final decision?

Senator DASCHLE. Well, actually, it would be nice if you could do all three: Option 1B, the final decision, and Option 1A, I mean, three columns, winners and losers. Just what is the analysis?

I think as we try to figure out what is the fairest way to proceed, I think it would be very helpful to know what the impact of these proposals are. And to be honest with you, I don't think that has ever been very clearly articulated yet. And I think you could do us a real service by providing that information in a way that goes beyond the data of that report.

Thank you, Mr. Chairman.

The CHAIRMAN. I would just underline Senator Daschle's thought. I tried to touch upon this, but, you know, literally, when you move from 31 to 11, this is what we asked you to do to rationalize it. But as you pointed out, you have got 36-populations that half won, half lost. And so as a result, even though the Committee, the Congress said reduce these, when it came down to the particulars, with 18-losers, they all weighed in, and there is not much in it. It is hard to get consensus with 18 pulling one way and 18 the other. But it is probably best, just for the sake of accuracy, to know how much.

Now, if these are de minimis changes, why, we might reason with our colleagues, now, come on, you know, 1-or 2-cents one way or another, given the variety of prices for dairy, for Class I milk or anything else, there is not much in it, and in the best interest, we might rationalize this thing.

On the other hand, if we see huge changes—when I visited with the Texas dairymen, for example, they saw a big change there in how they may have overestimated their problem, but they didn't think so. So as a result, they were dug in, and there were others like this.

But it would be helpful for us all of us to analyze this data because I think it is material.

Senator Grassley, I will pass on you for a moment. Your turn will come right after Senator Conrad. You may question for 5-minutes. Senator Conrad, would you proceed with your questions?

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you, Mr. Chairman, and I thank the witnesses as well.

First of all, I think the basic system under which we are operating here is really pretty hard to defend. It is pretty hard to defend a system that started in the 1930s based on presumptions that are no longer the case.

At the time this was all devised, the Midwest was the only surplus area, and that is just no longer the case. And yet this whole plan is predicated on a fact that is no longer a fact. And we don't seem to be able to reform this system, even given the best efforts of Congress and the best efforts of USDA.

First of all, I want to commend you for making the attempt, but I think Congress has really failed to meet its obligation and its responsibility. This is now an unfair system. It is absolutely unfair to our region of the country, and the results have been absolutely devastating. We have seen in the last decade our dairy farmers cut in half. Actually, it is even more dramatic than that, because that doesn't capture the most recent losses, which are very sharp.

So we have a system that is unfair, and you came up—we had three basic options before us: 1A, 1B, and the final decision, which is somewhere in between. I would be very interested to know—my understanding is that in the referenda the people indicated they preferred Option 1B. Is that the case?

Mr. CLAYTON. No. They were presented with the final decision, up or down.

Senator CONRAD. And they supported the final decision.

Mr. CLAYTON. That is correct.

Senator CONRAD. And the final decision is between 1A and 1B.

Mr. CLAYTON. It is probably—yes. It is sort of built off of 1B, but with some higher prices.

Senator CONRAD. You said, as I heard you in response to Senator Daschle, that 1A—this is how I heard you; correct me if I am wrong—that 1A would have given the highest level of receipts. Is that your————

Mr. CLAYTON. Between the three options, yes.

Senator CONRAD. But that doesn't measure, obviously, regional differences?

Mr. CLAYTON. No. I was just speaking nationally.

Senator CONRAD. And how much of a difference is there in overall receipts between the three, between 1A, 1B—which was the original Department recommendation, was it not? Option 1B was the original Department recommendation?

You have to answer yes or no because nods of the head will not be captured in the record.

Mr. CLAYTON. Oh, I am sorry. I thought you were going to continue. That is all.

Senator CONRAD. Option 1B was the original Department recommendation, was it not?

Mr. CLAYTON. That is correct. Yes, 1B was the initial proposal by the Department.

Senator CONRAD. And those who are the advocates for the status quo, the anti-reform group—I like that.

[Laughter.]

Senator CONRAD. I have been watching this Presidential campaign.

The anti-reform group, they wanted to stick with what is that is based in the 1930s. Isn't that correct?

Mr. CLAYTON. I will not join in your characterization, if that is okay.

Senator CONRAD. And the final decision is somewhere in between. Can you tell us the level of receipts between the three?

Mr. CLAYTON. Yes, Sir. Option 1B would have resulted in around $129 million less than what we would have projected if the existing system had continued. Option 1A————

Senator CONRAD. $129 million less in overall receipts.

Mr. CLAYTON. That is correct.

Senator CONRAD. Overall receipts to dairy producers.

Mr. CLAYTON. Cash receipts to dairy farmers.

Senator CONRAD. Cash receipts—okay. That is good.

Mr. CLAYTON. For dairy farmers who are marketing milk through the Federal Order Program.

Senator CONRAD. Right.

Mr. CLAYTON. Obviously, there are dairy farmers outside————

Senator CONRAD. OK. I think it is just very important to define these things for the record and for those who are listening. OK.

Mr. CLAYTON. Option 1A, if we would like to take that one next, we estimate will result in cash receipts of $104.9 million more than if the existing system had continued.

Senator CONRAD. OK.

Mr. CLAYTON. And the final decision would have resulted in $2.8 million less cash receipts to producers.

Senator CONRAD. So, in terms of this one question, the final decision really is right between the two.

Mr. CLAYTON. As it turns out, and, again, that is all relative to the kind of baseline of the world continuing as though we had done none of this.

Senator CONRAD. Now, as somebody who has been deeply involved in this process, how would you characterize the numbers of dairy farmers around the country? What is happening to the number of dairy farmers, active dairy producers?

Mr. CLAYTON. It has been declining.

Senator CONRAD. And declining sharply?

Mr. CLAYTON. Yes. I would not sit here and profess to be an expert on those numbers, but my reading of them would be that the decline has been significant.

Senator CONRAD. And can you tell us what kind of a price would a dairy farmer in the upper Midwest get versus what a dairy farmer in the Northeast would get? And let's put in the South.

Senator LINCOLN. Thank you.

Senator CONRAD. I don't know how you divide up the South.

By the way, I have already filed a lawsuit on behalf of Senator Lincoln against the Committee, and I am hoping that it gets resolved quickly.

[Laughter.]

Mr. CLAYTON. Well, I would be happy to provide sort of detailed information on that. I do have some examples of the difference in the all-milk price under the final decision compared to 1A.

Senator CONRAD. If you could get that to me and other members of the Committee—my time has run out.

Mr. CLAYTON. Sure.

Senator CONRAD. I would appreciate that.

Mr. CLAYTON. It might be easier just to provide more complete information, yes.

The CHAIRMAN. I thought it was very interesting. You have a $100 million loss one way, a $100 million gain the other, but your final decision was $2.8 million out of $9 billion—in other words, de minimis. So that was what we were arguing.

Senator Grassley.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. I am not going to take much of my time because I came to hear the producers and I want to move on. But I think I share the frustration just expressed by Senator Conrad and would associate myself with it, and add to it that we have the ironic situation, for instance, in my State—and I will bet it even applies to—if it is in northwest Iowa, it applies to parts of Minnesota and South Dakota, and maybe even North Dakota—where actually some times in the year you can have a milk shortage. And so we have instances in which processors, in some cases even our Iowa Department of Economic Development, are trying to entice people to come to our State from even California to produce milk so that we have got a supply. And it all stems from an outdated marketing order situation that was worried about surpluses in the Midwest. But because of the lowest prices there, we have got a situation where now we have potential unemployment in milk processing, dairy processing.

It is an example that if Government still has a legitimate role—at least as far as a safety net is concerned, they do have a legitimate role. But it is a perfect example if something isn't working, it has got to be fixed. This isn't one of these things you look at and say, you know, it is working.

So I associate myself with those remarks and just urge whatever can be done to be done to correct this situation where Government has proven that it isn't better than the marketplace.

Now, in this particular instance, if you are going to have a safety net for farmers, you are going to have to have some Government involvement. But it has got to be something that betters the situation and not worsens the situation.

The CHAIRMAN. Thank you very much, Senator.

Senator Lincoln.

STATEMENT ON HON. BLANCHE L. LINCOLN, A U.S. SENATOR FROM ARKANSAS

Senator LINCOLN. Thank you, Mr. Chairman, and thank you again for holding these important hearings.

I had hoped, as Senator Grassley, to be able to be here with the producers when they testify, but I am going to have to testify at another committee, and hopefully my entrance there will be a little more graceful in the second committee.

The Arkansas dairy industry plays a tremendous role in our State's agricultural economy, and it generates more than $270 million of economic activity every year for our State. Most people don't think of Arkansas as a dairy State, but we do have quite a few dairy farmers there. Unfortunately, Arkansas dairy farmers, like dairy farmers from all other areas, are struggling with volatile and low prices.

In the past 10-years, nearly 40-percent of our Arkansas dairy farmers have gone out of business. There are nearly 500-farmers left out of a number of well over 900 just 10-years ago. Recognizing those concerns, our Arkansas General Assembly approved the Southern Dairy Compact in 1997.

I am pleased to know that John Scarlett will be testifying in the next panel, and I appreciate his representation of the Southern dairy farmers. One of the comments that he makes in his testimony—and I just would like to highlight that—is that the program, whatever the program is, is only as good as the quality of the information it gathers. We have talked about shortages and other things, the importance of how we gather that information, and certainly making sure that we do it correctly and in a timely fashion is going to be very important.

I would like to ask this panel, seeing what has happened to dairy farmers in Arkansas over these past 10-years without a compact, what do we stand to see in the future? How long do you see Southern dairy farmers existing without a compact? You are here for your professional, and background in terms of these issues. What do you think?

Mr. CLAYTON. Well, that crystal ball is a difficult one to deal with.

Senator LINCOLN. Sure.

Mr. CLAYTON. Clearly, as you point out, dairy producers in lots of parts of the country are under financial pressure. Clearly, one of the driving issues, as the Chairman has indicated, is what we as a Government will choose to do to intervene on their behalf. Every intervention has implications which cut in a number of different directions, and probably not my place to try to attach significance to the importance of those impacts, be it on producers or on consumers. That is something that the public debate ought to sort out.

Clearly, there is a lot of change going on: fewer farms, as has been pointed out already, to some extent larger farms, larger farms in parts of the country where we haven't seen that before. To some extent, producers have to do what is necessary to be efficient, and I don't intend that as an indictment of anybody. But, clearly, at the end of the day we do operate in a market economy, and one has to operate efficiently to do that.

I realize I haven't answered your question, but———

Senator LINCOLN. I was just getting ready to say, that is almost the same as a nod of the head. Completely unrecorded.

Mr. CLAYTON. I am not going to, obviously, take a position this morning in terms of the appropriateness———

Senator LINCOLN. So you have no opinion as to—whether or not Southern dairy farmers exist can without a compact?

Mr. CLAYTON. Well, they have existed. I would guess that they can. But under what circumstances? We do not know, what the future will bring. We do know that there are going to be a lot of pressures there.

Senator LINCOLN. Well, I would just highlight Mr. Scarlett's testimony, and he points out, the very basics of transportation cost and what is involved in the South, where probably half the U.S. dairy farmers reside. When we run into those shortages that were mentioned earlier, the cost of transportation and what is involved and being able to make sure that there is a supply of milk. And let me tell you, I am pretty big consumer. I have got twin boys that are 3½, and we go through at least 4-gallons of milk a week.

So it is important, in areas, like the Mississippi Delta and the Southern part of our country, to have that supply and have it in a cost-effective way for consumers.

I will just highlight that, and I will tell the Chairman once again how much I appreciate his involvement in this issue, and certainly having the Committee to focus on it. Thank you, gentlemen. And I do appreciate the second panel, although I won't be able to stay.

The CHAIRMAN. Thank you very much, Senator Lincoln.

If there are no more questions, I think we will proceed to the second panel. But I want to thank both you, Mr. Clayton, and Mr. McKee for your testimony. Please furnish the Committee the information requested by Senators because you can tell from the intense interest on the figures that this is a subject that we are going to be into, and we really want to have the data to make sound decisions.

[The information referred to can be found in the appendix on page 287.]

Mr. CLAYTON. Yes, Sir. We will get that back to you.

The CHAIRMAN. Thank you very much.

The Chair would like to call now a panel composed of: Mr. Arthur S. Jaeger, Assistant Director of the Consumer Federation of America; Mr. Mark Furth, General Manager, Associated Milk Producers, Incorporated, in Minnesota; James Vanblarcom, a dairy farmer from Pennsylvania; Mr. James Tillison, Alliance of Western Milk Producers, from Sacramento, California; Mr. Larry Jensen, Senior Vice President of Supply, Distribution and Business Development of Leprino Foods, Colorado; and Mr. Dennis Meyer, member of the Board of Directors of Family Dairies, in Iowa.

Gentlemen, we thank you all for assembling here with us this morning. As perhaps you heard at the initial part of the hearing, we would ask that each one of you summarize your comments in 5-minutes. The green, the yellow, and the red lights are an indicator of how you are doing in this respect. And if you would do that, that would be helpful because then we will have another 5-minutes per Senator a round of questions of you following your testimony.

I will ask you to testify in the order that I introduced you, and that would be, first of all, Mr. Jaeger. Would you offer your testimony?

STATEMENT OF ARTHUR S. JAEGER, ASSISTANT DIRECTOR, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC.

Mr. JAEGER. Thank you very much, Mr. Chairman. I am pleased to be here this morning, and I am very pleased the Committee chose to hold these hearings. I think they are important hearings, and I think they were very instructive yesterday and so far this morning.

Last year's dairy controversies over the Northeast Compact and market order reform were most often portrayed and they were portrayed this morning as regional battles, New England versus the upper Midwest, the upper Midwest versus the rest of the Nation. I want to make the point that they were also consumer battles. My organization, the Consumer Federation of America, fought in favor of market order reform, the USDA's plan, and against compacts.

We were joined in opposing compacts by both Consumers Union—I think that is probably the Nation's best-known consumer organization—and the Center on Budget and Policy Priorities, a respected research organization that focuses on low-income issues.

Now, why are these programs problems for consumers? It is pretty simple. As a number of witnesses have pointed out, they raise retail prices to consumers. There was a lot said yesterday about prices in the New England versus the upper Midwest. I brought along a couple of charts which point out what the Northeast Compact did. This is milk prices in Vermont, and where my colleague is pointing—that is, June 1997—that is where the compact kicks in, and you will see a big increase in prices there. You will see prices, after the compact kicks in, stay pretty much at the $2.75 per gallon level.

This, by the way, is the same GAO report that Senator Leahy likes to cite.

Now, in the next chart, we have New Haven, and you will see essentially the same thing. It is not quite as dramatic. And there the prices tend to stay up at the $2.70 level after the compact kicks in.

In the next chart we have Chicago. That is getting out towards the upper Midwest, and you will see there is no compact in Chicago, and so the price bounces around. It does not go up in June 1997, and you will see prices in Chicago peak out at about $2.65.

And then the final chart is Milwaukee, and there, again, the prices bounce around, but, again, they peak out at about $2.65.

It is that problem in New England that concerns my organization, and we don't want to see the same thing happen in the Middle Atlantic States and in the Southern States.

It is interesting. A recent study commissioned by the Northeast Compact's own governing body basically reached the same conclusion, that there were dramatic increases in milk prices when the compact kicked in, and that it has continued to cost consumers a substantial amount of money in the 2½ years—well, that study only looked at the first year, but in that first year, it continued to cost consumers a substantial amount of money.

In terms of Option 1A, you heard estimates this morning, that Option 1A is costing consumers about $116 million more for milk this year. That is why we opposed Option 1A.

These price increases hit low-income consumers the hardest. That is because low-income families spend more of their income on dairy products. These higher milk prices cause a decrease in milk consumption. Again, there was some dispute over that yesterday, but Keith Collins, the chief economist at the Agriculture Department, certainly ought to know, and he said the Northeast Compact is decreasing milk consumption in New England. A slight decline in milk consumption, and that is what you are seeing. It may seem trivial, but the public health effects here may not be trivial. Milk, of course, as we all know, is an excellent source of calcium, yet something like three out of four of us don't get enough of it. Raising the price of milk will just make it that much harder to turn that situation around. And, of course, anytime you increase the price of milk, you do increase the cost of Federal nutrition programs.

I think we heard the USDA witnesses say this yesterday. Last summer USDA said Option 1A would increase the cost of the four major nutrition programs nearly $10 million per year. It is true that the Northeast Compact, to its credit, has acted to insulate WIC and the School Lunch Program, but there is not a lot it can do about food stamps. Estimates are that the compact is costing food stamp recipients nearly $10 million in lost purchasing power.

Supporters of the compact and Option 1A say they are needed to shore up struggling dairy farmers. My organization includes small dairy farm organizations and is very concerned about the decline in the number of small farms in this country. But we think compacts and Option 1A are not an efficient way to address this problem.

Why not? First, not all dairy farms—again, as we heard yesterday—in this country are struggling. Keith Collins mentioned that the basic Federal price for milk recently tumbled, but it tumbled from record-high levels. He also said that feed prices have been very low. He said about 2.5-percent of dairy farms are financially vulnerable right now, and that is about half the percentage for all farms nationwide. So compared to all farms, dairy farms are actually doing better.

Now, next, who are the farms that are struggling? They tend to be the small farms. Since 1982, three out of four dairies going out of business in the Eastern United States had less than 50-cows. Of course, when you change the farm level price of milk under either Option 1A or under compacts, you increase income on a per-gallon basis; that goes to all farmers. That means those with the most production get the most benefit. It gives the largest subsidies to those who least need the help. Some of these dairy farms have net worths of more than a million dollars. At the same time, the smallest farms, the ones that tend to need the help, get very little.

What if you ran the Food Stamp Program on the same basis—the more you earn, the more food stamps you would get? That doesn't make for an effective assistance program, and likewise, we think raising milk prices across the board for all farmers is not an efficient way to assist those farmers who are in trouble.

Now, what is the solution? Yes, there are farmers in trouble. My organization is worried about them. We think Congress would be better off to enact a permanent, targeted assistance package for those small dairy farmers who need help to survive. We think there is a value in keeping those farmers on the land. And Congress has started down this road with the emergency assistance packages it approved in the last 2-years. These programs don't just cover the Northeast. They cover the South, where there are problems. They cover the upper Midwest, where there are problems. They cover any region where dairy farmers are struggling.

These programs are capped in an attempt, at least, to target the benefits on the small-and medium-size producers who should need the help, and they do not increase prices to consumers. They do, of course—this approach does involve Government cost, but at least if this approach is done right, at least taxpayers know they are providing help to the small farmers who need the help, not to farmers who are doing fine.

I had a number of other points in my statement, but I will cut it off right there. I see my time is up.

[The prepared statement of Mr. Jaeger can be found in the appendix on page 288.]

The CHAIRMAN. Thank you very much, Mr. Jaeger.

It is a pleasure to have Senator Grams with us again today. He is a regular at the dairy hearings, and I am grateful that is so. But you have a witness that you would like to introduce, Senator.

STATEMENT OF HON. ROD GRAMS, A U.S. SENATOR FROM MINNESOTA

Senator GRAMS. Thank you very much, Mr. Chairman and members of the Committee. Thank you for giving me a distinct privilege this morning to be here to introduce to you Mr. Mark Furth, who is the chief executive officer and general manager of Associated Milk Producers, Incorporated, or AMPI, and it is a 5,000-member dairy cooperative based in New Ulm, Minnesota.

Now, AMPI annually markets 5-billion pounds of milk for dairy producers from Minnesota, Wisconsin, Iowa, Nebraska, Missouri, South Dakota, and North Dakota, and it operates 13-manufacturing plants.

Now, Mark has been with AMPI for 30-years, beginning as an accountant, and he became general manager in 1990. Mark has also previously served on the Board of Directors for the National Milk Producers Federation and also for the Minnesota Dairy Leaders Roundtable.

I appreciate his willingness to come to Washington today to highlight what we view as the fundamental unfairness of our Nation's dairy pricing system and to propose alternatives to the existing structure.

Now, Mark has endured the same frustrations that I have in Minnesota, with family farmers being forced out of business due to a system that helps producers in other regions of the country gain a competitive advantage over them.

Again, I want to thank you for the opportunity to be here this morning to introduce Mr. Furth and know that his suggestions will be useful for the work of this committee and for the Senate.

Thank you very much, Mr. Chairman.

[The prepared statement of Senator Grams can be found in the appendix on page 373.]

The CHAIRMAN. Thank you for coming, Senator Grams.

Senator GRAMS. You are quite welcome.

The CHAIRMAN. Mr. Furth, you are recognized.

STATEMENT OF MARK FURTH, GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER, ASSOCIATED MILK PRODUCERS, INCORPORATED, NEW ULM, MINNESOTA

Mr. FURTH. Thank you, Mr. Chairman. Thank you, Senator Grams.

These 30-years that I have spent working for dairy farmers as part of this cooperative called Associated Milk Producers, most of that time has been spent in one way or another with milk marketing and milk pricing. And whatever little bit of expertise that I have gained in those 30-years, that is what I hope to be able to share with you this morning.

In those 30-years, I have seen a lot of changes in milk marketing and milk pricing. Three changes that I think have been significant and that should bear on policy into the next decades:

One is that cooperatives have become the major marketing vehicle for most United States dairy farmers. Almost all United States milk today is marketed by dairy cooperatives. That is a significant change from 30-years ago. It has increased dramatically, continues to increase.

Second, 30-years ago, bottled milk, fluid milk, which you are hearing so much about this last couple days, was the major usage of milk by far and away. Today it is not. Cheese has become the major usage of milk in this United States, a significant change.

Lastly, marketing has become very national. When I joined this business some years ago, markets were very local. They are no longer. Almost all dairy products are marketed on a very national basis today.

In that same period of time, something that hasn't changed is that the two significant Federal dairy programs continue to exist almost exactly like they did 50-years ago: price supports and the dairy price support program. Now, to have that kind of longevity, they must either be very, very good programs or very, very outdated. Hopefully that is something that this committee will look at in the coming sessions.

Although these 2 programs are both over 50-years old, they have in the last 15- or 20-years taken a very different direction. Starting in the early 1980s, the national safety net for dairy farmers through the price support program has been significantly lowered. At the very same time, the support level offered to dairy farmers through things like Federal milk marketing orders has actually increased. While we have lowered the safety net for most of the Nation, we have raised it for isolated areas. Fluid Class I prices have actually increased, giving price relief to farmers with higher Class I utilization and the benefit of Federal price control.

To make this discrimination worse, reliable economic studies by the likes of USDA and Food and Agricultural Policy Research Institute [FAPRI] show that the relatively higher supports for some actually lower the price for the other dairy producers not so affected. Dairy is a national market today, with supply/demand setting the price and balancing the market for almost all products. Class I fluid use is a rapidly shrinking part of total U.S. milk production and an increasingly ineffective and unfair vehicle for supporting prices for U.S. dairy farmers.

Meanwhile, the United States is a very attractive market for the rest of the world. Without the import tariff rate quota system that we have, we would be a magnet for any surplus production anyplace in the world. If U.S. trade policy lowers import restrictions, as is contemplated by many, without first leveling the playing field here in this United States, those regions without the safety net of higher Class I prices and/or compacts will be sacrificed. I trust you will not let that happen.

We need a national dairy pricing system and a national dairy policy without regional distortions. I believe recently legislated Federal order changes and the Northeast Compact extension have further distorted our U.S. pricing system. How can Congress in good conscience consider international policy until it first ensures a fair domestic pricing system for U.S. dairy farmers?

As you consider another farm bill, I propose the elimination of Federal orders and compacts as poor policy that helps some farmers at the expense of others. I propose a strengthened national price support program for all dairy farmers in this Nation.

An effective national pricing system should include the pooling of all benefits and costs across the entire Nation and a two-tier pricing mechanism that provides disincentive for farmers to increase production into the face of a price-depressing surplus, similar to that existing today.

I hope this committee can reclaim jurisdiction over these issues. Your decisions will have a huge influence on the health of our industry for decades to come. Please ensure that dairy is a strong, healthy, and prosperous part of American agriculture. Give us a national policy, not a patchwork of regional manipulations.

When the ever famous Titanic set to sea, there was great confidence that new technology and new markets were unbeatable. The Titanic was so unsinkable that it provided life boats for less than half the passengers. You know the rest of the story.

As dairy sets to sea in a world market, it would be overconfident of us to eliminate price supports ad import quotas. The remaining safety net of Federal orders and compacts would save far too few dairy farmers.

Not only would we be short of life boats, but have preassigned seating besides.

Regional dairy policies must go. Our great industry and our great Nation deserve better.

Chairman Lugar and committee members, I thank you very much for the opportunity to testify this morning. The dairy farmers of AMPI have great confidence in this committee's ability to help craft dairy policy into the next century.

Thank you very much.

[The prepared statement of Mr. Furth can be found in the appendix on page 296.]

The CHAIRMAN. Thank you. I appreciate your testimony.

I have a note. Do you want to make a short comment?

Senator CONRAD. Could I just make a quick comment? The Budget Committee is convening at 10:30.

The CHAIRMAN. Very well.

Senator GRASSLEY. Is it 10:00 or 10:30?

Senator CONRAD. They moved it to 10:30.

Senator GRASSLEY. OK.

The CHAIRMAN. That would affect you also.

Senator GRASSLEY. Yes.

Senator CONRAD. And I appreciate very much this accommodation. I appreciate my colleagues. I agree with everything Mr. Furth just said. As I examine what we have been talking about this morning, Option 1A, Option 1B, the final order, it strikes me that all of those are basically rearranging the deck chairs on the Titanic. We have got a policy that is a failed and flawed policy, and we have got to go back to first principles and rewrite the dairy policy for this country. If we do not, we are going to see a massive elimination of dairy producers in this country, and we will regret very much sometime in the future looking back on a failure to act.

I just hope that people were listening as Mr. Furth testified because I think he hit on precisely what needs to be done.

Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you, Senator Conrad.

Senator Grassley, and then Senator Fitzgerald. I know each one of you needs to make comments at this point, and———

Senator GRASSLEY. I am going to wait until my constituent is done testifying.

The CHAIRMAN. Very well. Senator Fitzgerald?

STATEMENT OF HON. PETER G. FITZGERALD, A U.S. SENATOR FROM ILLINOIS

Senator Fitzgerald, if I may, I just wanted to make a comment before Mr. Clayton left the room. Is Mr. Clayton here? Thank you. I am sorry I wasn't here earlier.

I just wanted to mention the milk forward pricing pilot program that we established last year prior to our adjournment, and I was just hoping that we would be able to follow the congressional mandate and make the program effective by March 1st and publish broad guidelines as soon as possible in order to give dairy producers and processors the necessary details of the program. And, hopefully it would have a regulatory structure that makes it workable and not inoperable, and I would just appreciate it if you could let the Secretary and others know at USDA the importance of the milk forward pricing pilot program. I think it is very important to our dairy industry in this country. I think it would be a good step that would help a lot of people. And so I hope we can move forward with that. And I appreciate your taking that concern back to the Secretary.

Thank you.

The CHAIRMAN. Thank you, Senator Fitzgerald, and I would just second the Senator's comment. This is a very important program for our committee. You understand that. And we are really eager to know how the details are being formulated and what progress you are making. It is not a solution to the problem, but it is another tool that is important for the marketing for dairymen.

All right. Now, pardon me, Mr. Vanblarcom, for interrupting your train of thought, but we are back to the panel again, and we are pleased to have your testimony. Would you please proceed?

STATEMENT OF JAMES VANBLARCOM, COLUMBIA CROSS ROADS, PENNSYLVANIA

Mr. VANBLARCOM. Thank you very much. Good morning. My name is Jim Vanblarcom. I am a dairy producer from northeast Pennsylvania, Bradford County. My family and I manage a 100-cow dairy that we have owned and operated since 1974. I am also very actively involved in off-farm agricultural activities. I am the president of the Bradford/Sullivan County Farm Bureau, also serve on the Pennsylvania Farm Bureau's Dairy Policy Committee. I want to thank the Committee for providing the opportunity for me to give a brief perspective on how national dairy policy affects myself and other Pennsylvania dairy producers.

The economic impact of the Pennsylvania dairy industry is huge. Total milk produced in the State amounted to $1.73 billion. We are the fourth leading producing State in the Nation. While Pennsylvania's dairy industry continues to maintain a slow rate of growth in total milk production through greater producer efficiencies, our dairy farm numbers, cow numbers, and total market share of the Nation's production continues to shrink. In fact, about 30-percent of the State's dairy farmers have gone out of business in the last 10-years. At the same time, Pennsylvania dairymen have increased milk production by about 20-percent.

Milk price volatility has made maintaining an economically viable operation a real challenge. Price swings of 30- to 40-percent in 1-month has not become uncommon. I challenge anyone to run a business with this level of volatility that dairy producers have experienced in the past.

My brother farms next door with 120-cow dairy. We share equipment and labor during planting and harvesting seasons. In this cooperative effort, we both save money. We are both hard-working, experienced, knowledgeable dairy producers. My brother and I ranked third and fourth in milk production in Bradford County, which is the third largest milk producing county in the State. Even with our best management practices, if we had stakeholders, they would look at our present dairy operations as a poor investment due to the lack of financial performance.

I have three children, all of which have varying degrees of interest in agriculture. Under present conditions, I would understand them not choosing a career in agriculture because they have seen the ups and downs and experienced it personally.

Dairymen in the upper Midwest and the Northeast are slowly losing their ability to compete. Milk production is shifting to the West. Chart 1 shows that the percentage of milk produced in the Southwest, West, and California has more than doubled since 1970 to 1997.

The trends of westward and larger dairies would be all well and good if our only need is cheap milk. However, numerous consumer concerns come to mind. There are environmental issues created by very large dairies and future competition for water in the Western areas; also, most important, the lack of producers in proximity to the high population centers of the North and the Northeast. Over 25-percent of the United States population lives within a three-or four-truck-hour drive of Pennsylvania and New York dairy farmers. Just imagine how today's diesel fuel prices would affect a cost of California and Western milk in the city of New York.

What dairy policy changes can be made to address the current challenges I as well as other producers face? First let me say thank you as a producer for your action that was taken by Congress last year to address producer concerns on Federal milk marketing order reforms. With positive action on Option 1A Class I pricing differentials and the extension of milk price supports for another year at the current level, combined with component pricing that allows the higher of Class III or IV to be used as a Class I mover, we have avoided an even more disastrous scenario on producer prices than we are already experiencing.

I believe a regional approach to pricing milk is the best method to help stabilize producer prices and address producer price needs affected by local marketing conditions. If properly administered, we now know dairy compact pricing can bring benefits to producers, at little, if any, cost to consumers, with no impact on national marketing conditions. I believe the future national dairy policy should allow for expansion of dairy compacts.

I would like to finish up quickly with—there are two other tools that we would really like to have. The Dairy Export Incentive Program should be fully funded to help maintain our presence in an international marketplace, a revenue insurance program for dairy producers similar to that as provided for other crops. And my most important message: I love dairy farming, the way of life it creates, and with your help, I would like to someday retire and help my children take over the farm.

Thank you.

[The prepared statement of Mr. Vanblarcom can be found in the appendix on page. 298.]

The CHAIRMAN. Thank you very much, Mr. Vanblarcom, for your testimony.

We are honored that Congressman Sherwood is with us, and he has a word for the previous witness.

Mr. SHERWOOD. Well, thank you, Chairman Lugar. I would have liked to have been here a little earlier and said this before Mr. Vanblarcom testified, but he is one of the most respected dairy farmers, he and his brother, in Bradford County, and they run a very heads-up, modern, efficient operation, and they are well regarded in the community.

And I wanted to say that so that everyone would understand it is easy to come and complain about market forces, but what you have heard from Jim Vanblarcom is from a forward thinking, modern agriculturalist. And I think what he mentioned to you is that if we don't pay attention, we will soon have all the milk for the whole country produced on factory farms, and it will lead to the type of scenarios like we saw in North Carolina where we all saw all the hogs floating in the river. Well, when you get these huge amounts of animals in confined spaces, it is a different landscape than we have been used to. And I would like to urge you to think about if that is what we really want in the future.

Thank you very much, Chairman.

The CHAIRMAN. Thank you very much for coming to our hearing. We are honored to have you. We appreciate your comments about your constituent, and we appreciate that, too, having heard the testimony.

Mr. Tillison.

STATEMENT OF JAMES TILLISON, ALLIANCE OF WESTERN MILK PRODUCERS, SACRAMENTO, CALIFORNIA

Mr. TILLISON. Chairman Lugar, members of the Committee, I am Jim Tillison, executive vice president and CEO of the Alliance of Western Milk Producers, an association that represents the interests of dairy cooperatives in California and the milk producers who own them. We appreciate being given this opportunity to talk with you about the dairy price support program, international trade, and to provide a brief description of the California pricing system.

Few Government programs have been as effective as the dairy price support program. It removes excess milk from the marketplace in the form of butter, nonfat powder, and cheddar cheese. When demand is up, these products are released back into the marketplace. In this way, the program assures consumers that milk and dairy products will be available by assuring dairy farmers of a market of last resort.

In 1996, milk producers reluctantly agreed to phasing out the dairy price support program. At that time it was believed that the General Agreement on Trade and Tariffs would present additional opportunities for dairy exports. Unfortunately, that has just not been the case.

It has been estimated by cooperative dairy economists that the average producer milk price would drop from $1.50 to $1.75 per 100-pounds of milk should the support program end. The total cost to dairy farmers nationwide would be approximately $2.7 billion. We were successful in gaining an extension through this year and are hopeful that Congress will keep the program in place through the full term of the 1996 farm bill, at least at the current level of $9.90.

The alliance believes that the dairy price support program is far superior to producer income supplemental payments. The support program is market-oriented and much less costly than the supplemental income program. In the past 2-years, Congress has approved $325 million in emergency income relief to milk producers, with a maximum payment to a producer of $5,000. USDA estimates the cost of extending the support program at $300 million in total for 2001 and 2002. The net effect on producer income would be over $2 billion.

The alliance member cooperatives believe that the U.S. dairy industry came out on the very short end of the stick in the GATT negotiations. The United States' ability to subsidize exports has been dramatically reduced while the European Union is able to continue to subsidize hundreds, even thousands of times the quantity of dairy products that the U.S. is allowed to subsidize. An excellent example is the "Other" dairy product category—products like ice cream—where the European Union will be able to subsidize a billion pounds of product while the U.S. is limited to just 70,000-pounds.

Free trade appears to be a one-way street running toward the United States.

I have the privilege of serving on USDA's Animal Agriculture Trade Advisory Committee. Most of what we hear at the meetings is how our various trading partners are not living up to their trade agreements with us. That is why the alliance will work for a continuation of the support program and the Dairy Export Incentive Program until world markets are truly free but, more importantly, truly fair. That means the complete elimination of Government-sanctioned activities like the EU's export subsidies and New Zealand's state trading enterprise monopoly. Until that time, significant limitations should be put on all dairy product imports from countries that employ these and other trade-distorting activities.

The implementation of Federal order reform brings milk pricing in California and in the Federal order system much closer together. While differences still exist, the basic concept is now the same.

Like California, Federal orders now use product-based pricing. As a result, prices will track much more closely than they previously did between the two systems. For the past 17-months, the average difference in the cheese milk price between California and the Federal order reform system would have been just 3-cents per hundredweight of milk. The so-called California advantage is no more.

If USDA is going to continue to use the National Agricultural Statistics Service [NASS] price series, it should have the authority to audit all plants reporting product prices, and reporting by all plants should be mandatory. It should also have the authority to require the reporting of manufacturing costs and to audit plants to verify that these costs are accurate. This is what is done in the California system.

In summary, the alliance urges the extension of the support program and the extension and perhaps expansion of the Dairy Export Incentive Program [DEIP] program. In addition, this committee should take an active role in the upcoming round of trade negotiations. Your involvement will ensure that agriculture's interests are not subjugated to the trade interests of other industries or other purposes. The ability to produce food is a form of security that no country should risk. That is why this committee, as well as the House Committee on Agriculture, must assure their constituents they represent that trade will be fair, not just free.

Thank you for this opportunity, and I will be happy to answer any questions you will have.

[The prepared statement of Mr. Tillison can be found in the appendix on page 306.]

The CHAIRMAN. Well, thank you very much, Mr. Tillison. Let me just assure you on the last point, the Committee is extremely vigorous pushing our trade negotiators to the ultimate. We are disappointed in their results thus far, but, nevertheless, we will continue to visit with them right in this room because it is of the essence, and I think we all understand that.

Mr. Jensen, would you give your testimony?

STATEMENT OF LARRY J. JENSEN, SENIOR VICE PRESIDENT OF SUPPLY, DISTRIBUTION AND BUSINESS DEVELOPMENT, LEPRINO FOODS, DENVER, COLORADO

Mr. JENSEN. Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today. I am Larry Jensen, senior vice president of Leprino Foods. I also serve as secretary and treasurer of the International Dairy Foods Association [IDFA] and chairman of the National Cheese Institute, one of the constituent organizations of IDFA.

Leprino Foods is a family-owned company that has grown from making small batches of ricotta and mozzarella cheese for local delivery to the world's largest producer of mozzarella cheese today. We operate eight manufacturing facilities that receive milk regulated by the Federal Milk Marketing Order system and two manufacturing facilities that are regulated under the California State order.

Federal dairy policy is complex and has far-reaching impacts on the structure and competitiveness of the U.S. dairy industry. While we do not advocate total deregulation, we believe it is critical that Federal dairy policy evolve to be less intrusive on dairy markets and the industry. Federal dairy policy should allow natural regional and scale efficiencies to develop and manifest themselves in the marketplace. This means allowing milk production to flourish in highly efficient regions and facilitating a conversion to more efficient methods in traditional production regions. It is critical that greater efficiencies develop throughout the industry in the years to come so that trade barriers are not needed to protect our domestic markets.

One of the most complex aspects of Federal dairy policy is the Federal Milk Market Order system. The Federal order system is a potent tool in that by setting minimum milk prices to be paid by proprietary processors, it can greatly influence industry structure. As a result of the FAIR Act of 1996, USDA attempted to make several significant strides forward in their first effort to reform Federal milk pricing policy in the context of the new global market realities brought on by the WTO.

These advances included replacing the antiquated Class III milk pricing system, so-called Basic formula price [BFP], with a broader price measure tied directly to the national finished product value of cheese. Additionally, for the first time, all milk in major manufacturing markets will be priced on the components upon which cheese-making value is derived: protein, fat, and other solids.

Unfortunately, the Federal Milk Marketing Order reforms became highly controversial last year and led to several provisions in the omnibus budget bill that overturned significant portions of the reforms. While the final provisions did not directly overturn USDA's Class III price formula, there was much discussion regarding one aspect of the formula used to calculate the Class III milk price, the so-called make allowance.

The make allowance is one of many factors used in the Class III price formula, all of which combine to establish a minimum price level for milk based on the raw milk value of both cheese and whey. It is important to understand that the make allowance is not a payment to cheese makers, and its use in the Class III formulate in no way guarantees cheese maker profitability. The only function in the make allowance is to translate a finished product value of milk into the raw milk equivalent value for use in setting a minimum price that proprietary processors must pay under Federal orders.

We believe that the debate in Congress last year over the make allowance in the Class III price formula was largely based on erroneous preliminary estimates of the price impact of the new formula. Current USDA data shows that for the most recent 16-months ended in December of 1999, the only period during which actual data was collected to calculate both the old BFP and the new Class III price, the new minimum prices actually would have resulted in a slightly higher milk price.

While we are appreciative that Congress did not legislate over USDA's Class III decision, we are concerned with what we perceive to have been strong sympathy for increasing the market intrusiveness of the milk pricing system.

Today we have in place a Federal Milk Marketing Order system that is complex, still intrusive on the market, and highly subject to the tugs and pulls of the legislative process. The dairy price support program was extended for this year, and USDA just last week announced their support for extending it through 2002. One of the last decisions of Congress last year was to extend the Northeast Interstate Dairy Compact that provides a protected market for a small group of farmers to the detriment of other farmers and consumers. All of these changes combine to put the dairy industry further behind our global competition.

Mr. Chairman and members of the Committee, the U.S. cheese industry is now the largest user of farm milk and is experiencing strong growth in market demand year after year. We have a great opportunity to grow markets domestically and earn a great share of international markets if we keep our focus on the market and make sure that our policies pave the way rather than impede our progress. As you debate Federal dairy policy, we urge you to continue to adopt those policies that will allow the industry to flourish in the long term.

Thank you for the opportunity to appear here today.

[The prepared statement of Mr. Jensen can be found in the appendix on page 312.]

The CHAIRMAN. Well, thank you very much for that testimony, Mr. Jensen.

Mr. Meyer, before I call upon you, let me say that you are doubly blessed to have both of your Senators on hand, and I want to recognize the distinguished ranking member, first of all, because I think he wants to make a comment. And maybe he will also make a comment about you in the process.

[Laughter.]

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, RANKING MEMBER, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator HARKIN. Thank you very much, Mr. Chairman. I am pleased, along with my colleague Senator Grassley, to introduce Dennis Meyer who is with Family Dairies USA. He is—a good, capable Iowa dairy farmer, with a good family from near Dubuque. They have a great family, three sons. He owns 144-acres. He rents an additional 240-acres. He has a herd of 92-Holstein cows, is active in his church, active in his community.

Again, when I think of Dennis Meyer and his family and the kind of dairy farmers that we have in that area of Iowa, it just seems to me that is what we are talking about. How are we going to preserve opportunities and enable these family farmers and family dairy farmers to remain in business, not only in Iowa but in Wisconsin and other parts of the country? I don't mean to be parochial about the Midwest.

That is one of the reasons why I hope we are here and having these hearings: how we are going to keep Dennis and his family and thousands of them in Illinois and Wisconsin and other places in business. So I am delighted he is here.

[The prepared statement of Senator Harkin can be found in the appendix on page 278.]

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Well, you know, a person only has one biography, so there is not much I———

[Laughter.]

Senator GRASSLEY. At least that is true of Iowans.

[Laughter.]

Senator GRASSLEY. So I won't add anything, but obviously I am glad you are here. When you are done testifying, I am going to go to the Budget Committee meeting.

The CHAIRMAN. At least, Mr. Meyer, you have not been accused of reinventing yourself. You have just one life, and it has been a good one, and we are grateful to have you here today. Please proceed.

STATEMENT OF DENNIS MEYER, MEMBER, BOARD OF DIRECTORS, FAMILY DAIRIES, USA, BERNARD, IOWA

Mr. MEYER. Thank you, Chairman Lugar. Thank you, Senator Harkin, for your kind comments.

Good day and thank you, Chairman Lugar and members of the Committee, for this opportunity to share our members' concerns on dairy policy. As Senator Harkin said, I am Dennis Meyer. I am a dairy producer from Dubuque County, Iowa, in America's traditional "Dairy Heartland." My wife Darlene and I and 3-sons far 384-acres and milk 92-Holsteins.

Family Dairies USA is a grassroots organization representing over 6,000 small- and medium-size dairy farm families in nine Midwestern States.

The ultimate goal of this cooperative has been a single, national milk marketing order that treats all producers equitably. During the recent Federal order reform process, we sought basic reforms that bring needed equity and simplicity and move us toward our ultimate goal. These reforms included much flatter Class I differentials, broad order consolidation that raises Midwest Class I utilization much closer to the national average, a competitive Grade A–B pricing system recognizing the full competitive value of farm milk, and the inclusion of California in the Federal order system.

Though Secretary Glickman's reform package made only a modest step toward our overall reform goals, we nevertheless believed it was an important step toward a better system. Therefore, we are deeply disappointed that Congress interfered in the reform process by blocking the modest reforms in Secretary Glickman's final rule. Now that Congress has derailed those modest reforms, we urge Senate and House leaders to work with us to bring needed equity and simplicity through other means.

We are strongly opposed to regional dairy compacts. Compacts are contrary to our goal of a uniform national dairy policy that treats all dairy producers equitably regardless of where they live or where their milk is marketed. These unfair milk pricing cartels erect new trade barriers to the movement of raw milk among regions of the country. Like the Eau Claire-based Class I differentials, compacts legalize the principle that it is okay to maintain pricing rules that discriminate against many producers in some regions.

Since July of 1997, the Northeast Compact has fixed the regional price of fluid milk in the New England States. Since the compact was to be a transitional step between the outdated Federal milk regulation and Federal milk order reform mandated by the 1996 farm bill, Congress scheduled it to sunset in April of 1999.

Unfortunately, the opponents of dairy reform inserted provisions in the fiscal year 1999 appropriations bill that delayed the sunset of the Northeast Compact until October 1st of 1999, as part of a broader effort to delay and obstruct the reform process. And again at the end of last year, through the fiscal year 2000 appropriations bill, we saw the Northeast Compact renewed for 2 more years, through yet another backroom political deal.

The extension of the Northeast Compact has emboldened other States to pursue these regional dairy compacts in search of a quick, easy answer to the complicated problems of dairy policy. Many States have enacted or are considering legislation allowing them to join the Northeast Compact or form a Southern Dairy Compact. If Congress were to authorize the expansion of the Northeast Compact or a Southern Company, what was to be a temporary crutch in the New England States will engulf over half of the States and seriously endanger for the Federal order system.

A 1999 University of Missouri study shows that a majority of producers in the Nation would be harmed by the combined effects of regional compacts in the Northeast, Mid-Atlantic, and Southeastern States. Producers in every region outside of the Northeast, Mid-Atlantic, and Southeast stand to lose between 17- and 21-cents per hundredweight of milk, according to the study.

Congress should not approve agricultural policies that so clearly provide benefits to the producers of one region at the direct expense of the consumers of that region and producers elsewhere. Instead, there should be an effort to create a more rational and uniform national dairy policy. The Secretary of Agriculture should have the flexibility and authority to maintain a sound and cohesive national milk pricing policy, without the regional fragmentation caused by compacts.

Congress would be making a big mistake to further expand or extend the Northeast Compact or authority any new dairy compacts. Compacts are inconsistent with the broader Federal milk marketing order reform process laid out in the 1996 farm bill.

If we allow regionally biased policies such as compacts and high Class I differentials to control dairy policy, we will never move beyond the divisions that have plagued this industry. Let's work together to find a national solution to our national concerns.

Thank you very much for letting me air my opinion.

[The prepared statement of Mr. Meyer can be found in the appendix on page 317.]

The CHAIRMAN. Thank you very much, Mr. Meyer.

We will ask Senators now to observe a 5-minute limit on the first round of questions to these witnesses.

Let me ask, first of all, we have had some statistics furnished to the Committee in response to my request and others as to how profitable the dairy business is. And these are fragmentary statistics, but Texas dairy farms, at least in the material presented by Texas A&M, representative farms—and they differentiate this by large and mid-size and small, with small farms being 80-cows—were showing a rate of return of roughly 20-percent on invested capital, which appears to me to be a pretty high figure.

We had yesterday a dairy farmer from South Dakota, as I recall, who said over the years he had gotten about 5-percent on invested capital. We had an Indiana farmer who had a good year and got 19-percent, but admitted that was an abnormal situation.

Some statistics from Cornell University, presumably of New York dairy farmers, indicate a 7-percent return on assets. That is a different situation depending upon the debt and the leveraging, at least, of the capital that is involved there.

But the comment was made earlier, I think by Mr. Jaeger, that, by and large, these dairy farm results of return on invested capital appear to be substantially higher than what the Committee has seen in terms of return on, say, corn farms or soybean farms or cotton or rice farms. Admittedly, it is very hard in these discussions to pin this down. When I asked yesterday to the dairy farmers who wanted to modernize what return you expect on your capital, the most common answer was, well, we really haven't got into that. The question is we either modernize or we leave. But the comparison of how you might invest the money somewhere else was not a large consideration in this, although ultimately it may need to become.

I just want some feel from any of you, Mr. Meyer, for instance, and Mr. Vanblarcom, you are dairy farmers out there now attempting to make a living on this sort of thing. Does return on capital ever enter into your picture? Or is this such a traditional thing your family does that you just continue on doing it sort of hoping that the income will be sufficient? Would you make a comment, Mr. Meyer?

Mr. MEYER. Yes, return on investment does enter a lot. I am a highly leveraged dairy producer. I am, I guess, relatively started in the business. I have been doing it for all my life, but actually buying my farm and doing some building and so forth has been relatively in the last several years. So I am highly leveraged dairy farmer, and, yes, it does enter into it. When I go to my banker and do my projection for the upcoming year, it definitely enters into it.

It is also a tradition to me—I am a farmer. I have been a farmer. My father farms. I have got a brother that is a dairy producer. But it most definitely does, and I guess one statement I like to make is I am certain that none of you people would like to have half of your income taken away, you know, from you, and that is exactly what has happened to us in the last several months. And we don't know when that is going to change. And yet my input costs continue to rise. Right now, yes, feed costs are low, and I am in a situation where I produce a lot of my own feed. But my other—all my other expenses continue to, at best, stay at level or increase. And how do you—I know one person made the comment before that you must become more efficient. There is only a certain degree of efficiency that you can, you know, maintain.

We have an outstanding market in our country to sell fluid milk, to sell processed cheese, and so forth, and we need to work on that to try to better that market so that we as producers can stay in the business.

The CHAIRMAN. Mr. Vanblarcom, do you have a comment on this issue?

Mr. VANBLARCOM. Yes. My return on the dollar, I couldn't give you that exact figure right today for this previous year, but I can give you some figures that I looked up recently concerning the return and the net growth or net gain in value for a farm across Pennsylvania. The Pennsylvania Farm Bureau has a farm management service that keeps accurate records on a large number of dairy farms, and over the last 3-years, their net worth went up by 9-percent, but their net—or their total debt load went up by 10-percent.

The CHAIRMAN. Senator Harkin, do you have questions of the witness?

Senator HARKIN. Thank you, Mr. Chairman. I am sorry I wasn't here for all the testimony. I had read it, though, so I am familiar with what you had testified to and had in your written testimony.

I just wanted to ask Mr. Furth with AMPI, in your written testimony you basically advocate doing away with the compacts and the marketing orders and provide a stronger income support for all farmers. That is your basic position. And you also in your written testimony mentioned a 2-tier pricing program.

Now, some of us had advocated that 15-years ago, and I am just wondering: Is that still valid today or not? How would that work?

Mr. FURTH. Well, my vision of how two-tier pricing would work for dairy is an extension of the price support program and one that would set a better level of support for an adequate supply of milk, a lower level of support for milk that is potentially surplus.

Senator HARKIN. And that would be a relatively good level of support at the first level. Is that what you are saying?

Mr. FURTH. A lower level of support for that marginal amount of milk that is potentially surplus.

What dairy farmers, as most of agriculture, I suppose, is prone to do is that when prices get lousy, they are lousy because there is too much production. What does the average farmer do to react to that? Produce more. It is the only thing they can do to control the problem.

And so when less production is needed, they actually produce more, and that is what I meant in my testimony by————

Senator HARKIN. Because of all the fixed costs and everything like that.

Mr. FURTH. Sure.

Senator HARKIN. Farmers understand.

Mr. FURTH. Precisely. So I think that we need a price support program long term that provides some disincentive for that. When somebody like USDA is projecting a surplus in the coming year and we are already at a surplus, why provide any incentive—why not provide a disincentive to further expansion? I am not talking about quotas. I am not talking about telling each farmer what they can produce. I am talking about providing some financial disincentive to expanding into the face of a surplus. This could operate only at times when we were expecting a surplus. It could be phased back in and out based on those kind of projections. It is only on the margin. We are only dealing with a couple percent of milk production.

I am just saying that when a dairy farmer is getting ready to double his herd next spring, he ought to pencil into those considerations the fact that maybe that milk is going to be produced for a world market price of 8-bucks. And maybe he would hold off on his expansion for 6-months or a year.

Nothing to do with size. I am not talking about big farmers, small farmers. I am talking all farmers.

Senator HARKIN. I want to come back again to Dennis from Iowa. Now, you know as well as I do up in your area we have half as many dairy farmers as we did 20-years ago.

Mr. MEYER. That is right.

Senator HARKIN. A lot of them have gone out of business, and some of the smaller ones that were maybe milking a dozen or so cows, they are gone. You have got 92. That is a pretty good size.

A lot of people say to me, well, Senator Harkin, you are just old-fashioned, you are living in the past. These dairy farmers are going to go out of business. We are going to have these big dairy operations and milk a lot of cows, like we do with pork and poultry now.

I guess I don't have a real pointed question for you, Dennis, on that. But, you know, when you think about Dubuque County and your area there where you are from, and Jackson County and those nearby areas, I mean, you have good feed supplies, you have reasonable input costs, the same way in Illinois across the river from you, in Senator Fitzgerald's area.

What I am probing here is just to see how you feel about the future and whether you think there is a place for the size of operation that you have and to be able to continue that family farm size of dairy operation.

Mr. MEYER. Well, one comment that I would like to share with you is my veterinarian in my small community of Cascade—there are four veterinarians in that veterinary clinic. He made the comment to me, he said, If it wasn't for you dairy producers, we could shut the doors. I mean, Cascade was a very, very large hog-producing area with a lot of very efficient, very good hog producers. They are no longer in business.

I like to do my business locally at my Cascade—my little town of Cascade. I can go to Wal-Mart in Dubuque—nothing against Wal-Mart. But I can go to Wal-Mart in Dubuque or some place like that and maybe buy things cheaper. But I like to service the people that I go to church with, that my kids are in basketball with, or whatever. I enjoy doing my business locally. As these small and medium producers exit the business, those businesses begin to also exit the business.

We had 4-feed stores, four feed businesses in Cascade. We now have 1. We had two veterinary clinics. We now have 1. We had 3 implement dealers. We now have one.

Consequently, from a producer's standpoint or from the other side of the situation, a consumer of machinery, feed, and so forth, that eliminates my ability for shopping around. You have one price. You have one implement dealer to go to, and that is it. They quote you a price and that is what you have to live with.

So, yes, I certainly think that not only is there a place for them, but I think it not only is important for the small-and medium-size dairy producer, hog producer, or whatever, but it is also very important for urban America. These small towns will dry up and go away if we don't help with the proper marketing programs that we are talking about to keep us in business so that we can, you know, in turn keep the small communities in business.

Senator HARKIN. I share that. Thank you.

Mr. MEYER. Thank you.

Senator HARKIN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Santorum?

Senator SANTORUM. I would yield to Senator Fitzgerald.

The CHAIRMAN. Very well. Senator Fitzgerald?

Senator FITZGERALD. Thank you, Mr. Chairman. And I would like to thank all the panelists for making their presentations today, and I want to compliment our two dairy farmers here from the different parts of the country, Mr. Meyer from Iowa and Mr. Vanblarcom from Pennsylvania. And I guess I have a question for you, Mr. Vanblarcom.

I have no doubt that what you testified to is correct, that you would probably be a little bit better off if you were in, if Pennsylvania were in that Northeast Dairy Compact. I think you are generally correct on that. But at the same time, I have no doubt in my mind that Mr. Meyer would be a little bit worse off if that Dairy Compact were expanded. And, in fact, you would probably be better off at the expense of folks like Mr. Meyer in Iowa and in my State of Illinois and Wisconsin and the like.

And I guess my question would be: Why should Congress come in and prefer you to Mr. Meyer? You are both good people. You are both hard-working farmers. You are the backbone of our country. But why should we pick you as a winner and him as a loser?

Mr. VANBLARCOM. That is tough.

Senator HARKIN. That is a tough one.

Mr. VANBLARCOM. Land O'Lakes has saw fit to support the compact situation, and also, when you asked should the Government pick one person over another, at present, under the present situation, the Far West is being picked over the Middle West, Northwest—or North and Northeast. So it is taking place right now. And it is not going to be easy to find an equitable program, but as Mr. Meyer says, he is watching out for his interest, I am watching out for my interest.

We all care about the dairy industry as a whole. My concern is the Northeast consumer. If we lose our Northeast dairymen—and a lot of my area, the only thing we can grow profitably is forage. We harvest the win and the rain and the sun and put it through a cow, and we produce a product that the consumer can use readily. And it needs to be local.

My concern is not just myself, but it is the consumer also.

Senator FITZGERALD. Well, let me just say that I think that on other farm programs where we have one commodity that Congress wants to help, say, all soybean farmers or corn growers, there is a lot of support in Congress to do that, and we normally step up to the plate.

I think the reason these compacts are so divisive around Congress is because really we are being asked to prefer farmers in a certain region of the country, dairy farmers in a certain region of the country, over the others. And I guess I am real uncomfortable doing that, and obviously, my farmers are being hurt in Illinois, and so I am going to fight that.

But on a broader policy issue, we are one country, and balkanizing farmers by regions and breaking up their interests over these compacts is just not a good idea. If we started these compacts in corn farming or soybean growing or any other area, I think it would just be a horrible precedent. And I hate to see this kind of balkanization of the country and Congress being asked to pick out some winners by region. I think that is why compacts between States were looked with skepticism upon by our Founding Fathers, and they required congressional approval. They didn't allow States to enter compacts unless Congress approved it. And this is really the only one that I am aware of that allows trade barriers between States.

So I would hope that you and other dairy farmers would think about what the effect of these compacts is on farmers in other parts of the country that are not in the compact. If we put everybody in the compact, then the compact wouldn't be any good. The reason it is good for the Northeast is because they are benefiting at the expense of the ones who are left out of the compact.

But, with that, thank you all very much for appearing before us today.

The CHAIRMAN. Thank you, Senator.

Senator Santorum.

STATEMENT OF HON. RICK SANTORUM, A U.S. SENATOR FROM PENNSYLVANIA

Senator SANTORUM. Well, I guess to comment on Senator Fitzgerald's comments about the Northeast Dairy Compact, there are many of us in the northeastern part of the country who believe that we have had balkanization of agriculture for a long time. In fact, we just saw it during this drought assistance—I mean, excuse me, this emergency assistance for America's farmers. We went through the worst drought in 100 years in my State and in the Northeast and the Mid-Atlantic States. We passed an emergency supplemental for—something akin to an emergency supplemental for agriculture for $7.4 billion, of which $7 billion basically went to people who had produced too much and were having bumper crops. So we gave them $7 billion, and we gave $400 million to folks who didn't produce anything because of the drought.

Now, to me, I don't know about, you know, the average American out there, but, you know, those of us who have been sitting up in the Northeast doing our agriculture, not asking the Government for a handout, also sort of look at the balkanization saying, you know, we have been dumping a lot of our money into the Midwest and Southeast and all these program crops for decades, and we haven't asked for much of anything.

We are now at a point where agriculture in the Northeast is being threatened by a variety of factors, and we are coming forward and saying, hey, you know, it is our turn, we would like a little bit of help up our way.

Again, $7 billion goes to basically farmers in the Southeast and Midwest, upper Midwest, double AMTA payments. Less than 20-percent of my farmers get AMTA payments, and that is not true in Iowa. It is not true in many other areas across the country.

Again, the reason we rushed out there is because we had low prices. My folks would love to have just had a problem with low prices. They had low prices and nothing to sell. And we got nothing. My folks are showing up at the Farm Service Agency [FSA] office and getting 30-cents on the dollar for their drought relief. And we have folks up in other areas of the country getting double AMTA payments plus bumper crops.

Then you wonder why my folks come here and wonder, hey, how about us this time? We have been doing this for decades. Decades we have been dumping money. And farm programs have been written on this committee and other committees to benefit those who come to this committee and, arguably, fight for their people. God bless you. You went out here and did a good job, and folks in that area of the country did well.

But, you know, northeastern agriculture is important, too, and I think we have every right to come forward and say, you know, well, we are hurting. When you were hurting, we came and supported you, and now we are going through a very difficult time in our area of the country. And we want some support too. And whether it is with dairy—and I understand the problems with dairy. Mr. Vanblarcom and I have—I have been up to northeastern Pennsylvania and Bradford County and other areas to talk to farmers up there, and it is very difficult up there in the northeastern part of my State. And there are a lot of dairy farmers hurting bad, even worse than in other areas of my State.

As many of you know, I have had some concerns about the Northeast Dairy Compact because I find myself out here, as you just heard, not favoring the kind of agriculture policy that we have dictated about preferring one region over the other. And I think we have done that, and we may be in the process of doing that again when it comes to crop insurance. But we are going to work against that, too.

I hesitate to sort of say, well, since you guys have done it, we need to do some of it, too. I would rather have it to where we support folks who are out there doing a good job and not prefer one region over the other. So far we have not done that in this Congress. We have not done that in previous Congresses. And so I object a little bit to my friend from Illinois saying, well, it is—picking out one program and saying we are balkanizing and ignoring 99-other programs when we have done the very same thing to benefit his farmers.

And so I would just—Mr. Vanblarcom, you didn't say that, but I thought I would answer the question for you. And if you would like to expound on that at all, feel free to do so.

Thank you.

The CHAIRMAN. Well, thank you very much to Senator Santorum.

We have been joined by Senator Leahy. Do you have questions for the witnesses?

Senator LEAHY. Like he said.

[Laughter.]

Senator LEAHY. I would just reiterate what I said yesterday. In the areas where we have used the compact, consumers are paying less for their milk. It was interesting to note that in a couple of the States that are speaking so much against the compact, saying, of course, that they are only interested in the consumer, in their States consumers pay more for milk.

I was impressed with lobbyists who get paid hundreds upon hundreds upon hundreds of thousands of dollars who come up here in their very nice automobiles to say that they only influence for fellow dairy farmers. Well, dairy farmers in Vermont or Pennsylvania don't make this kind of money. They work very, very hard—harder than most people do. All they want is a fair return. The compact does it. And it doesn't cost the taxpayers anything. This is the most important thing. We are always asked in this committee to give huge amounts of money for corn farmers, for soybean farmers, for wheat farmers, for this type of producer or that type of producer. We are asking the Northeast, let's just run a program ourselves that won't cost the taxpayers anything.

By God, you would think that we had suggested the ending of all farming in America. Every one of these interests that rely on huge Government subsidies come in to attack the program, it gets nulled. No taxpayers' money.

I think it is a bad mistake. I am not suggesting it is the testimony of anybody here, but I am just saying it as a general statement. Group after group, region after region that rely upon billions of dollars of Government subsidies are opposed to a program that farmers have set up that has no Government subsidy. For the life of me, I think that it expands parochialism and hypocrisy beyond any level I have seen in 25-years here, and I have seen some levels.

So, anyway, that is just my thought, and I would suggest it is not balkanization. If some of these areas are so concerned about the Dairy Compact would show the same kind of initiative and the same kind of intelligence and the same kind of effort that the Northeast did, then do their own. And tell the taxpayers we will get out of their pocket and just do it ourselves.

Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Senator Leahy.

I just would comment, I am sure the witnesses can observe as Senators to testify that we have some disagreements of our own. And some of the echoes from your advocacy are heard here and even repeated in your presence. But we appreciate the rich variety of thoughts which you have brought in your oral testimony today and in your prepared papers. And we will take these seriously. They have been made part of the record, and we thank you very much for coming.

The CHAIRMAN. I would like to now call an additional panel to be composed of: Clark Hinsdale, president of the Vermont Farm Bureau, on behalf of the American Farm Bureau Federation; John Neal Scarlett, South East Dairy Farmers Association of Tennessee; John Frydenlund, director of the Center for International Food and Agriculture Policy of the Council for Citizens Against Government Waste; Will Hughes, Wisconsin Federation of Cooperatives; Gene Paul, past president of the National Farmers Organization of Minnesota, and Bill Brey, president of the Wisconsin Farmers Union on behalf of the National Farmers Union.

[Pause.]

The CHAIRMAN. May we have order again in the hearing room so that we can all hear the witnesses clearly?

Before Mr. Hinsdale is recognized, I want to recognize Senator Leahy.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

Senator LEAHY. Thank you, Mr. Chairman. I came down and, as you know, I am in another hearing, but I wanted to introduce Clark Hinsdale. He is a friend of mine and my family, has been for years. He is also president of the Vermont Farm Bureau. In fact, he is testifying before this committee on behalf of the American Farm Bureau Federation, a very significant testimony. And he hails from a multi-generation Vermont farm family. He runs a diversified dairy farm, and he has done a lot in Vermont. He has been president of the Vermont Farm Bureau for 7 years, and, in fact, after he became president, you saw a great revitalization in the Vermont Farm Bureau, a great expansion, and one that became very involved in a bipartisan fashion in our State. So he is chairman of that. He is chairman of the board of the Farm Family Insurance, a member of the board at Yankee Farm Credit, as well as what he does on his farm.

I will put my whole statement in the record, but I would suggest that if we listen to people like Clark Hinsdale, I think we can find a solution out of here. He has had to bring a lot of differing people, differing parties together to make it work, and he has done that, and thank you for having him here.

The CHAIRMAN. Thank you very much, Senator Leahy.

Let me just comment personally, in recognition of what you have said, that 4-years ago when I was running for a different office than the one I am now involved in, I visited with Senator Leahy and the Vermont Legislature and, likewise, the Farm Bureau leaders and dairymen in Vermont, and Mr. Hinsdale was a leader then. He has become an even more prominent leader on behalf of the Farm Bureau of his State subsequently. It is good to have you again in the Committee room, and please proceed with your testimony.

STATEMENT OF CLARK W. HINSDALE, III, PRESIDENT, VERMONT FARM BUREAU, INC., ON BEHALF OF THE AMERICAN FARM BUREAU FEDERATION, RICHMOND, VERMONT

Mr. HINSDALE. Thank you, Mr. Chairman. My name is Clark Hinsdale, as has been already said, and I am fortunate here to be presenting testimony on behalf of the American Farm Bureau Federation concerning national dairy policy. Our membership does include the majority of our Nation's farmers, and we seek to promote their interests in all regions of this country.

My message to you is, first and foremost, one of profound gratitude for what you have already done for us in the extension of the price support program, Option 1A, and many other things that have been mentioned here today, not the least of which is the extension of the Northeast Compact. These efforts have provided some measure of income stability and a greater measure of hope to our Nation's dairy farmers.

I want to personally thank you, Mr. Chairman, for visiting dairy farms in Vermont. You have not only entered our barns and our kitchens, but our hearts as well. Together with your predecessor, who has dairy literacy in his job description, we believe you can tackle some of the great issues of the day, from opening up world markets to ending our use of food, medicine, and land mines as weapons against innocent people who find themselves citizens of hostile regimes.

I might come back to our Northeast Dairy Compact. At a time when so much attention is focused on the need to improve agricultural risk management tools and to create an effective counter-cyclical safety net for farmers to facilitate our transition to a more market-oriented agriculture, the genius and efficiency of the compact should be apparent. Simply put, the compact extracts revenue from the marketplace, not the Government, operates only when prices are low, and doubly depends on the good will of consumers, both through their economic and political decisions.

In January, the voting delegates of the American Farm Bureau Federation reaffirmed their support for compacts by saying, "We support State and regional initiatives, or compacts, which are consistent with our overall goals of Federal market order reform and a market-oriented dairy program."

New language was also added to our dairy policy, stating, "We support modifications in the Federal marketing order that will enhance the price of milk received by producers, including, but not limited to, Option 1A price differentials for Class I milk, adjusting USDA formula for make-allowances on Class III milk, and regional dairy compacts."

With a track record of returning an estimated $40 million to dairy farmers both within and outside the compact region, the bushel is off the light. Twenty-five States have passed legislation authorizing regional compacts. We support legislation that would extend the current Northeast Dairy Compact to include Maryland, New York, New Jersey, Delaware, and Pennsylvania. The Farm Bureau supports the authorization of a Southeast Dairy Compact, extending westward to include Missouri, Oklahoma, Kansas, and the rising star of the Lone Star State of Texas. We encourage you to continue to allow producers and the industry to work together through such efforts as the Northeast and Southeast Dairy Compacts to stabilize producer income.

We appreciate the opportunity to visit with you on American Farm Bureau's perspective on dairy policy. We truly appreciate the progress that has been achieved and look forward to continuing to work with you toward agricultural policies that provide nourishment for the world, opportunity for our farmers, and security for our country.

I might also add that it is—in our problem-solving role in the Farm Bureau, it is of great value and benefit for me to be able to join you in hearing the very diverse testimony as we seek to find opportunities to guarantee in this country that our farmers have an opportunity to succeed.

Thank you.

[The prepared statement of Mr. Hinsdale can be found in the appendix on page 323.]

The CHAIRMAN. Thank you very much, Mr. Hinsdale.

Mr. Scarlett?

STATEMENT OF JOHN NEAL SCARLETT, ON BEHALF OF THE SOUTH EAST DAIRY FARMERS ASSOCIATION NEW MARKET, TENNESSEE

Mr. SCARLETT. Thank you, Mr. Chairman.

First, let me say I am glad to see that you all are going to enter the testimony into the record because, as slow as I talk, I might not get all mine in.

I would also like to thank the other members of the Agriculture Committee for holding these hearings and giving a dairy farmer from east Tennessee the chance to come up here and be heard.

My family and I run a 200-plus-cow dairy which was started by my grandfather in 1930. We market our milk as independent producers through an organization called Piedmont Milk Sales, a marketing organization which has about 260-producers in 5 Southern States.

I would like to begin my testimony by thanking the Members of the Senate who made sure that the flawed attempt to redo the Federal order regulatory system last year was corrected. I am all for making the system work better, and I think that is what Congress did. There are a couple more changes to make, but those will work their way through the regulatory process at USDA this year.

My purpose this morning is to let you know how important the Federal Milk Marketing Program is to the dairy industry in my part of the country. The main purpose of the Federal Order Program is to provide an orderly flow of fresh milk for the consumer. And in the Southeast, that is a real challenge in some months.

As most of you are aware, the Southeastern United States is a rapidly growing population center. That rapid growth makes it more difficult to have adequate supplies. But the added transportation cost of moving milk from areas of the country where there is more than enough to drink makes it more cost-efficient to maintain a healthy local supply of milk.

For instance, hauling milk from northeastern Wisconsin to east Tennessee adds $3.39 a hundredweight, which means that adds 29-cents a gallon, much more than the 4-cents a gallon they were talking about a while ago being added. And hauling from upstate New York adds 27-cents a gallon. Now, those are not figures that we just pulled out of the air. I called Piedmont before I left, and that is what they gave me when they had to have extra milk besides our local supply. The two charts attached to my testimony bear those out to other destinations in the South.

I want you all to know right up front I have no malice whatsoever in my heart for any of the folks that are dairy farmers in Wisconsin or New York or Iowa or anywhere else. But I have got many friends up there, and I want to stay friends with him. But you just simply cannot pay those farmers a fair return, pay the plant a give-up charge, load that on a truck and haul it to east Tennessee and put it on the shelf cheaper than what the consumers can buy my milk, irregardless of the program. Federal order minimum pricing, in the interest of farmers and consumers, provides a great financial incentive for keeping milk production low.

On that note, the local impact, which has been stated earlier by the dairymen from Iowa about what it does to the areas out there, is an extremely important point. There is about $6 million in milk checks that come back to our county where I live. Now, if you believe what the economist says, the multiplier effect, multiply that by six, that is $36 million that is spent there in our local economy. In Tennessee, we are a sales-tax-based State. That is how we build our schools, pave our roads, educate our children. And if you take that away, the only sales tax we get is off the milk that is hauled in, would be what comes out of the store. It doesn't provide any infrastructure money as the money that comes back in the milk checks does to be spent locally.

A local supply of milk is much more also than just cheaper. It is almost more dependable. Those of you here in the DC. area remember just a few days ago—it was on the news—of how bad it was to get to the office in the snowstorm. If it was hard for you to get to work, imagine if you were driving a milk truck or trying to pick up milk and get it to the plant and the stores within the Southeast.

The bottling plants in our area were begging for milk 2-weeks ago, and milk was readily available. Now, imagine what it would be like if all the milk supply you had, had to be trucked in.

The Federal Order Program also provides financial functions that are important in the entire marketing chain. It ensures Class I producers are paid the prices if milk is sold as beverage, Class II is used in cheese and yogurt, Class III for manufacturing, Class IV for milk for butter. Producers also assure that they are paid for the components.

An entirely understandable question by this committee then is: Does the market still work? I can tell you from recent experience it certainly does. The parts of 1998 and 1999 weather-related difficulties in areas of the country kept milk supplies tight, and we had record-high prices. Now the situation is reversed, and they are at low prices as we have seen in the last 20-years.

To put that in context for all the non-farmers in the room, imagine trying to feed your family, pay your mortgage, educate your children by having your paycheck cut 40-percent.

The position I am, a dairy farmer every day, if the milk produced on my farm doesn't move that day, I do not have a product to sell by the next day. That is one of the most critical features of the Federal Dairy Program. It keeps dairy farmers on an equal basis from being pitted against each other.

We have heard a lot of talk about deregulation. First, let me say the current farm bill does not authorize deregulation, it does not require changing Class I differentials, and it certainly did not want to lower the income of the average dairy farmer. That is why it is so important for Congress to intervene to repair the flaws in the marketing order. Without those changes last year, entire investments in facilities would have been very dramatically affected.

Another aspect of the price regulation I would like to finish up with is on compacts. I would like to say the Southern Dairy Compact would be a great help to the industry in our area to keep the fast-growing market in the Southeast adequately supplied with reasonably priced fresh milk. Compacts also allow everyone in the milk marketing chain to have a say in how milk is priced.

On the subject of compacts, I would like to call for a higher level of honesty in the debate of this issue. For instance, calling compacts undemocratic simply isn't true. Over 5,000 legislators in 25-States have voted in favor, and an amendment last year with dairy compact language in it in the Senate here received 53-votes. Still, we do not have a compact in the South, therefore denying the people and their legislators that spoke of having the benefit of local dairy farmers retain them in their communities.

Another reason I wanted to be here today is to have the opportunity to remind this body and the American people that there is one group that is clearly not sharing in the economic boom of the country right now. As I said before, milk prices are the lowest level in 20-years, and the Federal Milk Marketing Order provides at least a small degree of stability, although more is needed.

I urge the U.S. Senate to continue looking for ways to keep farming economically vibrant and American farmers and rural communities having that opportunity for economic gain.

Again, I thank you for the opportunity.

[The prepared statement of Mr. Scarlett can be found in the appendix on page 326.]

The CHAIRMAN. Thank you, Mr. Scarlett, for your testimony.

Mr. Frydenlund.

STATEMENT OF JOHN E. FRYDENLUND, DIRECTOR, CENTER FOR INTERNATIONAL FOOD AND AGRICULTURE POLICY, CITIZENS AGAINST GOVERNMENT WASTE, WASHINGTON, DC.

Mr. FRYDENLUND. Mr. Chairman and members of the Committee, on behalf of Citizens Against Government Waste, I want to thank you for this opportunity to testify on the subject of whether there is a need for a Federal dairy policy.

CAGW is a 600,000-member, nonprofit, nonpartisan organization, which grew out of President Reagan's Private Sector Survey on Cost Control, better known as the Grace Commission. The organization's mission is to work for the elimination of waste, mismanagement, and inefficiency in the Federal Government, with the goal of creating a Government that manages its programs with the same eye to innovation, productivity, and economy that is dictated by the private sector.

The Center for International Food and Agriculture Policy institutionalized CAGW's long-standing goal of dismantling Depression-era agricultural price supports and regulations. In addition to a belief that Congress should build on the accomplishments of the 1996 freedom to farm bill and achieve a truly free market for agriculture, the center advances the philosophy that the best way to wean America's farmers off the Federal dole and assure them a prosperous and secure future is to promote a more open global food economy by dismantling barriers to free trade.

CAGW applauds you, Mr. Chairman, for holding this hearing, particularly for asking the right question: Is there a need for a Federal dairy policy? It is appropriate to begin a discussion of dairy policy with such an examination, rather than the traditional assumption that there should be a dairy program, which then simply moves into a debate of what that program should be and how much money should be allocated on its behalf.

It is now well past 60-years since the Federal Government first determined that it needed to be involved in milk pricing. The result was the creation of a dairy price support program and the Federal Milk Market Order system. There may arguably have been some justification for Federal subsidies and management of dairy production way back then before vast technological progress, modern production techniques to maximize output, efficiency, and quality, and advancements in the Nation's infrastructure made these policies obsolete.

During seven decades of modernization and change outside of Washington, the Federal Government's stranglehold on milk-pricing structure has remained constant.

Just as is the case in every other industry, technological innovations have allowed some dairy farmers to become more cost-efficient. It should come as no surprise, then, that this country has experienced significant reductions in both the number of dairy farms and milk cows. The time has come for leaders to acknowledge that these trends represent progress rather than a cause for hand-wringing.

Until relatively recently, the cost of Federal meddling has been most blatantly demonstrated by the excesses of the dairy price support program, which laid out huge sums of Federal taxpayer money to dairy farmers. Now, however, the Federal dairy program is a tangled web of mind-numbing pricing schemes that have metastasized into a more layered, incomprehensible, intrusive labyrinth increasingly divorced from economic realities. Rather than allowing the marketplace to determine the price of milk, dairy prices are controlled by behind-the-scenes maneuvering in Washington, bureaucratic log-rolling, and regional political favoritism that we have heard so much about already today.

I have brought along a chart that truly illustrates how mind-boggling the system is that has been built over the last 60-years.

As with many other Government programs gone haywire, intervention in the dairy industry was designed to be temporary. And as I said, until recently, the dairy price support program had been the cornerstone of the Federal Government's involvement in the dairy industry. In the late 1970s and early 1980s, price supports were driven to unprecedented heights as a result of regional politics and election-year payoffs which ultimately ended up costing the taxpayers $17 billion during that decade and led to the voluntary diversion program and whole-herd buyouts.

These experiences have led to less congressional enthusiasm for raising dairy price supports, but as this developed, the milk marketing orders have become the most important bulwark of Federal involvement in milk pricing.

Within the milk marketing orders' logic-free zone, the most illogical of all provisions is the differential pricing. These additional premiums are charged to the manufacturers of fluid milk based in part on how far the manufacturing plants are from Eau Claire, Wisconsin.

Perversely, the differential system penalizes dairy farmers in the regions best suited to dairy farming and rewards dairy farmers operating in high-cost, inefficient areas far from Eau Claire. This makes about as much sense as the Federal Government requiring computers manufactured in Maine to be sold at higher prices than those manufactured in the Silicon Valley.

It is equally ludicrous that the Federal Government established minimum prices for milk or sets different prices for milk based upon what it is used for. I would also like to point out that the extensive and time-consuming effort initiated in the 1996 farm bill to provide modest reforms of the system, which was scuttled by Congress last year in the extension of the Northeast Dairy Compact, was a serious setback for reform of the entire industry.

Interstate dairy compacts represent a threat to the long-term viability of the dairy industry, and without going too much into detail about all of our objections to this sort of milk cartel system and providing what really is a milk tax on consumers, I would like to point out that what we need to do is really look at dairy policy, get outside of the box of just debating between the different regions and deciding who are winners and losers. This unbelievable system that has been developed over the years is only getting more complicated every time Congress decides that they are going to try to equalize things or intervene to try and make the system more fair.

It has been demonstrated by the producers that have testified here today that there is no system that this Federal Government can put together that is ever going to be fair for every dairy farmer in the country. If we are going to try to have a social engineering policy that must determine that we never lose another farmer from the land, then this is not the way to do it because you cannot even do this fairly. The only way, then, if that is going to be the goal that the Congress decides on, a social engineering policy to make sure that every farmer has a fair income, then Congress needs to get rid of the milk marketing order system, get rid of the dairy price support program, and come up with a farm income assistance program, some sort of supplemental assistance that is directed to the farmers in need. And it is really the only logical scheme left.

[The prepared statement of Mr. Frydenlund can be found in the appendix on page 331.]

The CHAIRMAN. Thank you very much for your testimony.

Mr. Hughes?

STATEMENT OF WILL HUGHES, UNIVERSITY OF WISCONSIN, CENTER FOR COOPERATIVES, MADISON, WISCONSIN

Mr. HUGHES. Thank you, Chairman Lugar and Senator Harkin, for having me to testify today. I don't know if it is an advantage or a disadvantage, but I am only representing myself today, and I am speaking as a staff economist for the University of Wisconsin Center for Cooperatives.

I have also had the honor to grow up on a dairy farm in the Northeast and now reside in the Midwest. And I haven't tried the West out yet, but if looks like if you want to do dairy, you should be looking at that area as well.

I think my first point today is that there is a tendency to exaggerate how important Federal orders are in the marketplace today. There is also a tendency perhaps to over exaggerate how bad they are. But what I want to address is the question of whether the playing field is level, this equitability question, after all these reforms have taken place and we spent a lot of dollars and time in the last 10 years working on it, and that is, I think, why I was invited here today.

The answer to the question "Is there a level playing field?" is a resounding no. You, Mr. Chairman, used the word "de minimis," and I like that word and will now put that into my portfolio.

In my written testimony, there is an Appendix a. It is near the last part of the testimony, and it is a chart, a bar chart that shows the distribution of Federal order benefits in the new system versus the old system distributed across regions. And these benefits range from a low of 37 cents a hundredweight to a high of $3.63 a hundredweight. It is a crude measurement. I can give you sophisticated analysis that I have reference in my written testimony that would show you about the same thing on a slightly different scale.

With respect to Class I milk, Federal orders have not been reformed, and I am showing that in my Appendix b's that are attached in the testimony.

If you look at Appendix b1, that chart shows a plot of Class I differentials in Federal orders east of the Rocky Mountains by distance from Eau Claire, and the large black dot represents USDA's final rule. And as you can see, it moved the system slightly to the more equitable plane.

FAPRI, which is a group that does forecasting and analysis on policy, worked with USDA and came up with a consensus forecast, and I would hope that this committee would look at that forecast. It was really underutilized in the debates in Congress this last session and other information was abused to show worse results. But that shows that 60 percent of the dairy farmers in the States were benefited under the final rule proposal, and I would like you to look at that.

Appendix b on the opposite page shows what we have with the new 1A differentials, and it hardly looks like reform at all.

There are some other technical details that suggest that we could have even raised the Class I price surface more than we thought, and it relates to the Class I mover and changing the Basic formula price [BFP].

Ask yourself the question: Do Federal orders increase milk production? Our analysis at the University of Wisconsin suggests they do so by about a billion pounds. A billion pounds in the pipeline has quite a price effect. They also decrease cheese prices by about 4-cents per pound, according to our analysis. And they also, therefore, affect the cheese milk, or the milk used in cheese, by about 40-cents.

Compacts do the same thing as Federal orders, only in a more dramatic way. Our studies at the University of Wisconsin suggest that compacts create many more losing farmers than they do benefiting farmers. For example, in my testimony, I refer to analysis that the Northeast Compact, if you included New York and Pennsylvania, would add $237 million on about 12 percent of the farms in the country versus taking away $146 million spread off a larger number of farmers and, therefore, per hundredweight a lesser amount of a loss.

So I am here to tell you that the world without regulation would be pretty flat. I know there was a little discussion yesterday, but Cornell did some analysis for USDA as to what would the price surface look like, relative prices amongst areas, and they found it to be—and they were looking at this in the aspect of without regulation. And they would say that there would be quite a narrowing in the range from how we are regulating prices. And that work was used to formulate Option 1B, the final rule, and so on.

Our history of trying good intentions has caused vicious cycles of surpluses and low milk prices, the high supports in the 1980s, the 1985 increase in the differentials, we had to come up with buyouts and diversion programs and so on. This is the law of unintended consequences.

Building a national dairy program that treats farmers equitably is essential, and that is what should preoccupy this committee until the job is adequately done, and I am confident and hopeful, knowing the interests that sat at the table these 2-days, that can be done. I think it is going to take a little trick, which I will get to in a minute.

This is going to be complex because, as you have heard, there are low-cost areas, high-cost areas, high-cost producers, low-cost producers. There are manufacturing areas, then there are fluid areas. And the bottom line is, in trying to come up with balancing a system that works for all those players in equitable ways, I think we are going to have to back off, as Mr. Jaeger said here, and be more simple and basic in our approach. That ought to run on the principle that less regulation is superior to more regulation, and we ought to focus on helping the industry manage this downside price-risk problem that we see repeatedly in recent years.

So what should we do? Short term, 1- to 2-years until we get to the farm bill, say no to more or extensions to compacts. I have a chart in my testimony that speaks to that. You have heard about the price support program and the DEIP program. I do think that is an important part of the safety net. At current levels, they do not distort markets and work as a reasonable safety net.

I think Congress should consider additional direct payments, assuming prices will remain low for the next year or so. Direct payments at the levels and distributions that are possible will not distort markets, and they are the most effective means of supporting.

Farmers don't like them that I have talked to because they are perceived as a handout, but if they are tied to price levels and they are truly needed and targeted, I think they can be effective.

The farm bill, congressional leadership. Steve Gunderson tried this several years ago and it didn't work. But if there was more broad-based congressional leadership that laid down the hammer that you will deregulate all regional programs unless the dairy industry and USDA develop a new national program, I think it can be done, and it will require that hammer be put in place.

I believe if we don't move to replacing Federal orders in the future through these other kinds of programs or, alternatively, adopting a California-style system, we can see the system self-destruct over time. And I see time and time again that farmers value these programs.

The problem is they become an entitlement, and lawyers would say a property right, as you see this inequitable distribution of benefits, and that has to change.

Finally, keep developing tools that help dairy farmers manage price risks and revenues by encouraging forward contracting options, maybe some support on premiums for that, and I agree with an earlier gentleman, look at that revenue assurance as another vehicle.

Is there a need for a Federal dairy policy? Yes. Will consumers go without milk without one? No. Would the size and structure of dairy farming be different without dairy policy? Yes, it would be. Do we need to ensure a local supply of milk via Federal policy? No, we should not do that. There will always be local milk production. Promote fair competition, and farmers and the industry will find ways to produce milk where it is needed. Be careful of protecting the past without hindering the future.

Thank you.

[The prepared statement of Mr. Hughes can be found in the appendix on page 339.]

The CHAIRMAN. Thank you very much, Mr. Hughes.

Mr. Paul.

STATEMENT OF EUGENE PAUL, LEGISLATIVE COORDINATOR, NATIONAL FARMERS ORGANIZATION, AMES, IOWA

Mr. PAUL. Mr. Chairman, on behalf of the National Farmers Organization, we want to express our appreciation to you and Senator Harkin for holding these hearings today.

Our organization represents independent producers nationwide in negotiating contracts and other terms of trade for grain, livestock, and dairy. And our purpose is to help independent farmers extract the dollars they need to cash flow their operations.

Dairy farmers today are facing some devastating situations. The current dairy policies have brought extreme price volatility to the dairy industry. Since September, the basic formula price has decreased by about 40-percent.

The milk price today is far below the milk production costs experienced by dairy producers in this country.

We can see the turmoil this has caused by looking at the exodus of dairy operations over the past years. Since 1992, approximately 30-percent of our dairy farmers have gone out of business. With that, it has had a negative impact on the rural businesses and infrastructure as well.

USDA's dairy pricing reform leveled the field of milk pricing to the lowest level found for milk in the country. The dairy pricing reform was designed to function like California's State order pricing system. The gains from being competitive with California's milk pricing system cannot be worth the further demise of this Nation's dairy industry.

The majority of America's milk production is being utilized for the production of dairy products. A great deal of focus has been placed on Class I milk. However, Class I differentials are important, but most of the milk is used for the manufacturing of cheese priced in Class III.

USDA's new dairy pricing system and the California State order milk prices are set using end product pricing formulas to establish the value of milk to be used for the manufacturing of cheese, butter, and powdered milk. End product pricing formulas alone do not find the true value of raw milk. Raw milk has a value before it is processed into a dairy product. Raw milk's value is the cost to produce the milk, such as the hay, grain, equipment, utilities, and labor.

Another major issue with end product pricing is the setting of a make allowance level. Make allowances assist the milk processors in covering the production costs of the plants; whereas, the milk-producing segment of the industry receives no production cost consideration at all.

It has been said that the dairy industry can export or trade its way to a healthier condition. This idea has been the fix-all, save-all remedy for what ails the dairy industry. However, a recent economic report on this issue from the University of Wisconsin shows the fallacy in export salvation for America's dairy industry. The report predicts the direction and amount of milk price change for America's dairy producers as a result of free trade to be a negative 0.4-percent. Basically, chasing freer trade for the dairy industry will result in lower milk prices for America's dairy producers.

Some have looked at the Canadian market as a market to be opened and conquered by this country's dairy industry. All this would do would be to lower the Canadian dairy producers' milk price to an inequitable level. The gain to America's dairy producers by ruining Canada's current dairy system would be minimal, if any gain at all.

The situation we are facing today is the issue of price, and I fail to see how lowering price in one area will benefit another. Why not raise the price in the lower-priced areas to those areas which are receiving a higher price? To this end, to provide some stability in milk prices, the National Farmers Organization supports the Northeast Dairy Compact Commission and the expansion of the compact and the creation of similar entities to help producers extract more dollars from the market.

In addition, a dairy industry milk management program has some benefits and should be given an opportunity in the United States. We encourage a mandatory system; however, a voluntary system could be established with the cooperation of dairy producers and dairy cooperatives using a coordinated and systematic culling of producing cows.

To deal with the situation facing us today, the National Farmers Organization is requesting emergency action to be taken by USDA to establish a floor price for the price of milk in all Federal Milk Marketing Orders. We are calling on USDA to initiate emergency rulemaking proceedings to institute a milk floor price of $13.50 per hundredweight for Class III milk.

The economic situation facing America's dairy producers today must be addressed. Without quick action in the form of price relief, which National Farmers Organization has requested, financial disaster will plague America's dairy producers causing many more to exit the industry.

Thank you for the opportunity to speak to you today?

[The prepared statement of Mr. Paul can be found in the appendix on page 355.]

The CHAIRMAN. Thank you very much, Mr. Paul, for your testimony.

Mr. Brey.

STATEMENT OF BILL BREY, PRESIDENT, WISCONSIN FARMERS UNION, STURGEON BAY, WISCONSIN, ON BEHALF OF THE NATIONAL FARMERS UNION

Mr. BREY. Thank you, Mr. Chairman, Senator Harkin.

On behalf of 300,00 farm and ranch families of the National Farmers Union, I would like to thank you for the opportunity to testify. I am Bill Brey, the president of the Wisconsin Farmers Union. I have been a full-time dairy farmer from Sturgeon Bay, Wisconsin, in northeast Wisconsin, and I farm there with my wife and family. We milk 95-cows and run 600-acres of alfalfa, corn, barley, canning peas, and soybeans.

Many people would say that Wisconsin is ideally suited to produce milk. Yet, nowhere is the economic devastation brought on by low prices more evident. My State has dropped from over 40,000-dairy farmers in the 1980s to 21,000 as of January 1st. With prices hovering around $9, farmers will continue to be put out of business.

National Dairy policy has become very contentious with one region pitted against another. However, it is the strong belief of the members of National Farmers Union that only by working together can we move forward to a national solution.

I have worked to implement this strategy in my home State. When we made plans for our 69th annual Wisconsin Farmers Union convention held in Eau Claire, Wisconsin, on February 4th and 5th, I invited producers from all regions of the country to participate on a national dairy producer panel. Our panel included dairy farmers from Vermont, Alabama, Texas, Minnesota, California, and Wisconsin.

My testimony today will include two sections: National Farmers Union support for continuation of dairy policy at the Federal level, and the principles of agreement reached by panel participants.

National Farmers Union [NFU] believes there is a strong need for Federal dairy policy. NFU supports continuation of the Federal Milk Marketing Order system, the dairy price support system, dairy nutritional programs, and dairy export programs.

Federal Milk Marketing Order system. While the Federal Milk Marketing Order system is not perfect, it provides important protection for both producers and consumers. The system provides testing and standards and helps ensure the orderly marketing of dairy products throughout the United States. It ensures producers are paid for the products they deliver and provides consumers with a safe and healthful supply of dairy products wherever they live.

We believe that some changes are needed. The National Farmers Union supports reform of the Federal Milk Marketing Order system on Class III and IV, as directed by Congress. In particular, we are concerned that the new, higher processor manufacturing allowances set by USDA will result in less producer income. Farmers are questioning why processors should receive a guaranteed cost of production for manufacturing, even while farmers are left at the mercy of the market. We are considering the benefits of a variable manufacturing allowance that would adjust in the relationship to the producers' milk price.

Dairy price support program. The dairy support price sets a floor on the price received by all producers, regardless of region and regardless of how each producer's milk is used. National Farmers Union favors a dairy price support program that is set at a level sufficient to curve market volatility. The current level of $9.90 per hundredweight is too low to act as a stabilizer. And I would like you to make reference to page 5, a chart which shows the support price was an effective price stabilizer until the late 1980s, when it was reduced too far below the average market level.

The 5-year average base price for milk, the basic formulate price, is $12.78. Therefore, our members believe a support price of $12.50 would protect against the huge drops producers have experienced in the past few years. Commodity Credit Corporation purchases may need to be capped to limit Government costs and avoid surplus product.

A stable supply benefits processors by keeping plants operating at capacity. Decreased volatility would also benefit consumers who pay more when farm prices increase, but seldom see a corresponding decrease when farm prices go back down.

Immediate relief. In the short term, we believe that the Commodity Credit Corporation should continue to provide emergency assistance to farmers, for example, the $125 million appropriated by Congress in last fall's emergency funding. However, assuming that funding is distributed in the same manner as 1999, these payments are likely to be in range of 14 cents per hundredweight, with a maximum of $3,600 for any producer. This would be a payment of approximately $1,400 for the average Wisconsin producer. The feed alone for that same size producer would be about $7,000 for just 1 month. Since USDA is projecting significant drops to dairy producers' income for 2000, emergency assistance will be more important than ever.

Dairy compacts. Our members have called for a nationwide solution that will ensure opportunities for all dairy farmers, regardless of region. National Farmers Union will support dairy compacts to the extent they are coupled with a support price that is high enough to stabilize price and enable producers to earn a fair return from the market.

National dairy trade policies. There is often discussion about whether various U.S. dairy programs are allowable under the World Trade Organization and how our programs will affect the United States' ability to negotiate further agreements. We would point out that U.S. farmers produce 160-billion pounds of milk per year and export only 3-billion. Since the lion's share of our milk, 98.2-percent, is sold in the United States, it is imperative that the United States maintain an ability to operate domestic programs for food security. There is no financial advantage in supporting policies that lower the market price to producers on 98.2-percent of the milk just to increase exports.

In addition, since the world market is heavily subsidized, we support maintaining the DEIP.

Food and Drug Administration standards. We believe that the standards for a hearing by FDA to change the definition of natural cheese that thereby allows the use of imported milk protein concentrate would displace domestic milk used for manufacturing, resulting in great program costs and lower prices to dairy farmers.

Regional disagreements have caused some people to ask whether total deregulation would be preferable to maintaining national policy. However, we believe the benefits provided by a Federal dairy program far outweigh the items of contention.

In conclusion, I would urge Congress to try the same strategy. Thank you, Mr. Chairman.

[The prepared statement of Mr. Brey can be found in the appendix on page 362.]

The CHAIRMAN. Well, thank you very much, Mr. Brey.

Let me just begin the questioning by commenting that in the panel today and, likewise, yesterday, the trade policy question arose in testimony of many witnesses. Essentially, yesterday the testimony was that American dairy producers, by and large, are not competitive with imports from New Zealand and Australia that are not subsidized, not very competitive against the European situation, which is heavily subsidized and almost overwhelming. And, therefore, the solution was essentially barriers to imports, both to protect against those who were more efficient as well as to level the playing field against the preponderance of the subsidy of Europeans that might come in. This is with regard simply to the producer side.

Now, on the consumer side, consumers would argue that imports might lower the price of milk, however it came, subsidized by the Europeans or free market by the Australians or New Zealanders, and, therefore, the quality of life for most Americans, but not for dairy producers, would increase.

I don't know whether a fortress–America situation is tenable indefinitely. It probably is temporarily because agriculture negotiations have broken down very badly. There is a glimmer of hope that something might start at the WTO. It happened in Geneva this week. But that has prospects for months and years of talking about anything. And so as a result, this is probably not going to change.

What I ask all of you, however, is during the course of this interim period, is it likely that American dairy producers will become more efficient, costs will come down, so that if we ever do get into a situation of world trade—which I suspect we will at some point; I don't know how you maintain immunity to all of this indefinitely—that we will be competitive?

If not, I suspect that we are in for some difficulty, but do any of you have any feeling about this? Most of you have said—in fact, all of us are calling for efficiency and lower cost, but we don't understand the dairy business. You can't lower cost at some point. You just simply are there, and it is a tough business. Therefore, if you can't produce efficiently, you protect what you have got, in essence, in a fairly mature market where the amount of demand does not increase much year by year, maybe a 1 percent increase per year, very modest over the last decade.

Does anybody have any comment about do we become more efficient? Does it make any difference? Or is the trade policy you are advocating—namely, keep the imports out and don't get really mixed up in this WTO business—is that the best we can do? Yes, Sir?

Mr. HINSDALE. Well, of course, we focused here, since this is a dairy hearing, on trying to balance the equities within dairy, and then, of course, we can slide into the larger, more challenging question of balancing equities across commodity lines. And it is, of course, interesting and unique that over 98 percent of dairy production is for use here in the country as opposed to the picture in other commodities where it is upwards in the 50-percent range or something, like wheat.

You know, as we have seen the consolidation in U.S. agriculture, essentially you get the consumer consolidation in supermarkets, you know, driving everything all the way back to the chain, and we have seen the consolidation in poultry and consolidation in hogs. And dairy is the other bookend because it is so capital-intensive and so strongly geographically rooted that it is probably one of the most difficult forms of agriculture to achieve the concentration and efficiencies that have taken place elsewhere.

Certainly from the American Farm Bureau's point of view, we need to continue to move in the direction of freer and fairer trade and simply recognize that a bulky, capita-intensive product like milk is kind of the bookend over here.

But certainly in the American Farm Bureau, we recognize that the collective interest of agriculture is served by continuing to try to move ahead with world trade.

The CHAIRMAN. Well, certainly that appears to be the testimony of the American Farm Bureau here in the Committee. In other words, essentially the testimony, as I understand it, is that the dynamics of American agriculture, the expansion of our income, the potential for American farm families to do a whole lot better comes from, as you suggest, exporting half of our soybeans, a third of our corn, maybe a quarter of our wheat every year. The failure to do that almost is bound to depress prices, depress income, make things miserable for most of the farmers that the American Farm Bureau represents.

So the dairy thing comes as a very distinct difference from this situation. In other words, is the American Farm Bureau position with regard to dairy that, despite the open business, all the delegations, the Farm Bureau, going to Geneva all the time and so forth, that here we sort of draw a line around America for this situation—which is not a very dynamically growing situation. You know, in essence, you gentlemen are talking about something that is very, very stable.

Now, if we were to talk about increasing demand for dairy, it is going to have to be with some other customers somewhere else in the world. But what I am suggesting is, if our costs are much higher than some other people who are also competing in the rest of the world, our chances of making those sales are not very good without DEIP, which means we then subsidize exports to try to improve our position.

You know, now, maybe this is just the way that it is, that we have a cost structure here that is not very competitive, a very mature market, and, therefore, we are constantly dividing up the pie, either by region or by classes of milk or however many tiers you want to look into the pricing. If so, that is a serious problem all by itself, plus the fact that, as we heard yesterday, there appear to be large differentials of return from large cow operations as opposed to medium as oppose to small.

And I would just say anecdotally from my own experience in Indiana, each time that I visit with dairy people, typically confidential meetings we want to have, and inevitably it is the 30-cow operation, a 65-year-old man and a 40-year-old son, and the 65-year-old man would like to figure out how to retire, how to get some equity from this situation and how to entice the 40-year-old son to keep going. And the 40-year-old is not sure he wants to do this for 25 more years.

They come to me and they want a magic solution: What can the Federal Government do to help our situation? Well, lots of things, but typically these people the next time around in that county are not in business. They are among those that are being described today as the casualties of the process.

Now, I think, Mr. Frydenlund, you mentioned—or maybe Mr. Hughes, if our policy is the retention of every one of these farmers, then we really will have to have a very different policy altogether, very targeted at the 30-cow people, or the 40 or 50 or so forth, because these are really hurting. They are on the margin, and when the price goes down, it really becomes tough. Or the reinvestment question, how do you get more competitive, or how do you refurbish the infrastructure of what you got?

Do any of you have any broad thoughts? Some of you have expressed those, and I don't mean to diminish that, but sort of help us in this situation because we are discussing now why in this panel we have a policy, why we have programs, why we are doing any of this, as opposed to something, a distributional chart of how we divvy it up regionally.

Mr. BREY. Mr. Chairman, I would like to get back and kind of couple the whole—there were many questions you asked, and I would like to lay it a little bit from some experiences that I had.

One is that us as dairymen in the United States, when we look at the dynamics of what world trade is and we see that the Chairman is from New Zealand and we see also—I have been on some dairy panels around the world, and the Chairman is also representing dairy, the vice chairman on the dairy committee side of it. That lets—and when we look at production costs and efficiencies, I think we have to look at—in our United States, if I have a 26,000-pound herd average, which I have achieved, I am probably most efficient as far as pounds per cow. If I change that—if I look at that, and my cost of that has been hovering around the $14, $15 hundredweight like everyone else.

If I lay that over and I say to the New Zealander, who has grass-fed cattle and no concentrates, no dry matter intake, no machinery, no grains, especially none imported from Indiana, from that standpoint, I am using up the efficiency that I am comparing it as.

So when you look at New Zealand that exports 95 percent of their product and has to put it on the world market, that is their agriculture, they have to force it someplace. And from our standpoint, why should the United States be importing and force our domestic price to compete with the unrealistic benchmark of inefficiencies or efficiencies of that $7 versus what it costs me to produce my milk?

The CHAIRMAN. It is a very important piece of testimony. You know, correspondingly, when I talk to friends from New Zealand, they would say you folks in Indiana have ideal conditions for production of corn. God has given you 39 inches of rainfall fairly steadily almost every year, and without irrigation, without other cost factors that enter into other situations, you have got a very low-cost product which you send everywhere. And we certainly try to do that. Delegations go from Indiana all over the world trying to sell corn on the basis that we are low-cost and do have enormous geographical weather advantages. Some would say the same thing for wheat in wheat country and what have you.

This is the problem. Now, it may be that we decide that dairy is distinctly different, and that really, I suspect, has been the decision of the Congress without distilling it quite this way, that we have something here that is very different from corn or beans or even pork, which now you have a surplus production and we export and do so competitively where once we didn't maybe 3 or 4 years ago.

Do you have a thought, Mr. Hughes?

Mr. HUGHES. Yes. I am not a trade expert, so with that as a caveat, you can find data around the country that can show you different results, but I believe—like looking at Cornell summarizes financial information on New York dairy farms, and we have some in Wisconsin that show that productivity is increasing on a 1-to 2-percent-a-year basis.

The CHAIRMAN. In dairy?

Mr. HUGHES. In dairy. Costs are going down. But USDA statistics are not showing that.

The CHAIRMAN. Well, why are they different? Why are your figures different?

Mr. HUGHES. That is a good question. Can't answer that for you. It is a methodological issue.

The CHAIRMAN. I see.

Mr. HUGHES. But the incentives in Europe, where they have production controls, they manage very intensively to lower costs. And so particularly in the UK, Denmark, and the Netherlands, they can compete with the U.S. pretty well. Some of the other countries are not competitive with the U.S.

New Zealand and Australia, you know the story there. They can run forage very efficiently through cattle.

The analysis that I have seen that I respect somewhat is that if you could get to free trade, fair, free trade—that means eliminating European subsidies and opening up access to markets—you could see the gains to New Zealand and the losses to the European, with about a wash for the U.S. So the problem is how to get there. And you have heard Mr. Tillison testify about people cheating and there are all kinds of institutional arrangements, and it is that how do you get there. And I am quite skeptical that you can leap to that situation without considerable shock to dairy producers in the country.

The CHAIRMAN. Well, I would be skeptical, too, you know, for the reasons that all of you have given, namely, we have an impossible predicament with the Europeans.

I am just trying to think down the trail. There may come a day when we have a different group of Senators sitting around here, a different feeling in the country, and people will say, well, this dairy business has gone on long enough. There will be a reforming spirit coming through here, and people will say consumers ought to benefit, all the rest of us. And, by golly, if we want milk for 20-percent less, the dairy farmers will say, well, that is totally unfair. It is a cheap food policy, and these people are unreasonable, and we are all going out of business and so forth. But consumers may say, well, that is one of those problems. We all have problems. And looking out after number one, namely, my family, as a consumer I would like to have cheaper milk.

At that point we better have a cost structure, and I am heartened by what you are saying, Mr. Hughes, that while all this argument is going on somewhere else, somehow productivity is going up, the cost structure is improving, and, you know, that is the most heartening evidence because, you are right, USDA doesn't show that. Now, they may not be polling the same farmers or looking at the same data, but we are trying to look for some good news here, even while the fortress is holding and the political support for it.

For the moment, there is political support in the Congress for roughly the programs that we have; otherwise, they would have been dispensed with a while back. But they have not been. But I think in part it is because the public doesn't understand how milk is priced. Most Congressmen don't understand how milk is priced. This is such a byzantine argument that, by and large, there is sympathy for dairy farmers and for other farmers. So, by and large, money is voted to help them out.

Now, what some of you are saying is, even as we are voting it, have we thought through who it is we want to help. Now, I think, Mr. Paul, you have suggested that essentially—or maybe Mr. Brey, that small farmers, when we had these general distributions, don't do particularly well because it is on a per-pound basis or whatever. The big get more money. That is true of all Government programs unless we have a very targeted cap sort of thing.

One of you suggested, well, do a $12.50 general support, but cap it off. Now, you could work that one to a point, I suppose, where you has a pretty heavy cap. I mean, it came way down so that only very small dairy herds were benefited. That would be a more direct way of keeping all those folks in business so long as they could make it on other grounds. And people think about those things from time to time. Then other people come in and say, well, after all, we have got a herd that is 80 cows, sort of a good, average herd, or a couple of hundred, why are we being discriminated against?

Now, you can go around and around, but to the extent that anyone wants to address this, what about a policy in which we have no compacts, we have no marketing orders, but we do have a support price and it is higher, with the thought that some of you are suggesting that it needs to be, because our costs are way up, well above $12.50, you are saying, I think, in most farms. So this is well below cost. It is sort of a safety net, and we have a national policy. What would be wrong, just hypothetically say $12.50, and eliminate compacts and eliminate marketing orders and just say $12.50? Then, if so, what kind of a cap? Is this for everybody? Does it offer incentives for overproduction? Some of you were suggesting we want disincentives for overproduction.

Does anybody have a thought about this? Yes, Mr. Frydenlund?

Mr. FRYDENLUND. Mr. Chairman, I would just caution that any sort of artificial increase in the support price gets us down the same road that we went in the 1970s and 1980s where the artificially high support prices led to increased production and———

The CHAIRMAN. To another whole-herd buyout or something of that sort.

Mr. FRYDENLUND. Yes, it is a dangerous way to go. Now, I don't—if the assistance is somehow managed with some sort of targeting, that might have less of an impact. But I am not really sure how that would work.

I do want to just say that I think that the efforts of members like yourself in Congress that have been pushing for a global marketplace, or at least pushing for the World Trade Organization to level that playing field, in the long run I think that is going to be of more potential benefit for the entire dairy industry than probably anything else. In fact, I would argue, without sounding too critical of the entire dairy industry, that the time and effort that the dairy industry has spent debating over which way to go on marketing orders and which way to go on support prices has all been focused upon a very small—just the domestic market. And I think that the dairy industry itself has failed to look at opportunities out in the rest of the world, and that is a much bigger market than our very limited static number of people here; whereas—and I know that there are difficulties. For instance, bulk milk is not probably something that is going to be easily exported, but even in other commodities, you know, wheat, feed grains, etc., the growth opportunities there are more and more becoming in value-added products, in processed products, than just in the bulk commodities.

So the same dynamic could exist for dairy, and I think if we didn't have these programs that basically just keep us looking inward, there would be a greater incentive to produce for the world market.

The CHAIRMAN. Mr. Brey?

Mr. BREY. Mr. Chairman, what I tried to illustrate in the example is that the 5-year average per hundredweight is $12.50. As of this time, we have very little surplus, certainly not in cheese. And if we would raise that price and keep the $12.50 rather than the $10.10 that we are—why we are here today talking about the big picture of it, the Northeast Compact in a sense would not call for itself because it would be coming from—it would be non-regionalism because we would all be receiving that $12.50.

We said that wouldn't be on all—I think it should be capped for the like the family or farm unit————

The CHAIRMAN. Well, how many cows?

Mr. BREY. Probably 2-million pounds, 2- to 5-million pounds per farm. I take that out of the Minnesota publication, the university, average—the profit per cow ranges anywhere in between 50- and 100-cows. Those are the top graphs as far as income return per cow.

Well, if that is the case, then at a 20,000-pound herd average, you are at 2- to 3-million pounds per cow. So that is kind of what that economic unit would be. Then the rest could be left to—if there is—an export market or something of that nature. But in order to keep this exodus from losing in our State alone 20,000 families—and the projection is it will cut another 10,000 out probably in the next 5-years, just not only because of age but because of this downward pressure.

The other question that————

The CHAIRMAN. Just let me stop you for a second. Without putting too fine a point on it, you would say give the $12.50 to farmers that have 100-cows or less, in essence, using the 20,000 times 100-cows or so.

Mr. BREY. Or up to 100-cows.

The CHAIRMAN. Up to 100-cows.

Mr. BREY. For everyone.

The CHAIRMAN. Now, then everybody else gets whatever the market price is. In other words, there is no support there. So at that point, you are on your own. Is that essentially right?

Mr. BREY. Pretty much so.

The CHAIRMAN. OK. Please continue.

Mr. BREY. You know, we talk about supply and demand. USDA projects the projection in 1999 and 2000 will reach 164-billion pounds. Meanwhile, the commercial use forecast has also been increased. Commercial use on milk equivalent, milk-fat basis, including commercial exports, is forecast at 167-billion pounds, up from last month's forecast.

Well, why are we in such a downward pressure if we are asked—if the projection is 165-billion and the need is called for 167-billion? This signal from USDA should say that there is a demand for milk, bringing this price up, not to where it is being depressed.

The CHAIRMAN. Well, the USDA I think testified yesterday that the price will go up. It always is lower in January. And by June or July, if we had the hearing, it would be a more cheerful group.

But, nevertheless, you know, you have to average these things over a year. You have these cycles, but maybe not that much. Likewise, we heard yesterday there is quite a new demand for cheese. Now, the cheese price, as opposed to the whole-milk price, is pretty favorable. So, in essence, consumer demand seems to be increasing for cheese, whereas it is very stable for whole milk at these prices.

I don't know how that factors into the 164/167, but it is an important figure. As you say, there may be a little more demand there.

Yes, Sir?

Mr. SCARLETT. Mr. Chairman, I would like to go back to the purpose of the orders when you are talking about doing away with orders and only having the price support. The purpose of the orders there, be ever how many they are, the 31 or now the 11, the purpose of those orders is to provide—make sure there is a supply for the consumers of milk or dairy products in those areas and to make sure that is a stable thing.

So I would question highly about going only to a support price and doing away with the orders because you have different needs in different parts of the country as far as the consumer needs. And also, as far as————

The CHAIRMAN. Well, Mr. Scarlett, on that point, some have testified that even though—you make a good point, and that is one reason we have had these marketing orders—that milk can be supplied from other regions fairly rapidly, in other words, that consumers in Tennessee will not be without milk if marketing orders don't exist that are that narrow. The 31, maybe the 11 still gets you there, maybe zero.

I think Mr. Hughes is testifying—and I think you answered your own question. Would consumers get milk? You said yes. But, in essence, you are saying not necessarily, as I understand it.

Mr. SCARLETT. Well, Mr. Chairman, not necessarily, because we have talked about the policy of keeping the farms and—of course, I guess being my size of dairy, I would tend to disagree with Mr. Brey over there.

The CHAIRMAN. His cap is too low?

Mr. SCARLETT. The cap. A nice fellow down home, they milk about 400-head, and he said he never had a cold cookie until he got married. He didn't know what it was. He didn't get a cookie when it is hot. He has got give other brothers, and they are all there. Do you penalize them for all staying on the farm and saying because they milk more, do you divide it out per person? I mean, I guess it would raise in my mind some serious questions about that.

But we have also talked about market policy and what the consumer wants and what we—you said yourself the consumer wanted maybe the dairy at X-number of price or 20-percent less or whatever it happened to be. But as in my testimony, we have got—another issue to consider is the effect on the rural communities and the effect on the economies within each State, and there are many variables to that, that if you eliminate those, we would have to bring into consideration of does the consumer—would they rather pay—would they rather have that milk check coming back to the community and being spent in there, or would they rather have to pay more for their schools and pave their roads and direct taxes, or how do we handle some problems like that?

The CHAIRMAN. That is a very important set of questions. This committee wrestles, if we are on a different subject, on community development, with just that idea. How do we get more vitality back in hometown America and get more banks and more jobs and everything else? A lot of farm families need those jobs in order to supplement income they have on the farm.

Yes, Mr. Hughes?

Mr. HUGHES. Well, I can't answer all of your questions. They are too heavy . But the idea of having a policy that is going to keep X-number or all farmers in business is probably unrealistic, in my opinion. Farmers enter and exit farming for lots of different reasons. Part of it is the price horizon. What do they expect their price and income capabilities?

But the experiment in Vermont and in the New England States with, you know, who has been exiting and what size farms they are, where they have stabilized and increases prices, looks to me, based on at least anecdotal evidence, that the smaller-herd size exit faster in Vermont relative to the U.S. and their larger herds grow more. So there you are providing that umbrella for the expansion. Well, why do farmers expand? Well, they want to have more income units to cover more families, and you are not going to be able to stand in the way of that process. And you shouldn't, in my opinion.

The CHAIRMAN. Well, it is an interesting question.

Mr. HUGHES. On capping, unless, you know, we are going to get this country to full supply control, which————

The CHAIRMAN. It sort of oversimplifies the question, but Mr. Scarlett's point on this, if we cap this off at 100-cows at $12.50 and you have a market price, conceivably consumers would be happy. The price of milk generally in the country would be much lower. All the Government money would be going essentially to one group of people, but not to 300 more cows Mr. Scarlett has, and so he would be selling a lot of milk very competitively. That might or might not fit the community development idea of the checks coming back to Tennessee or other situations, but it does rationalize the question.

Now, this is one of these things in which there is no theological answer. Pragmatically, these decisions happen because Members of Congress push and poll and broker the situation on behalf of their constituents, as has happened before. But, nevertheless, as a preface why we are having these hearings, we came to an impasse last November in which some people won and other people lost.

Now, people who lost said in order to stop the train of our filibuster, you are going to have to re-examine this. And many people are very skeptical about these hearings. I heard some comment yesterday that we were going through the motions and that, in essence, nothing is going to happen. Well, maybe so, maybe not.

As I said at the beginning of the hearing, we will sort of poll our members, having heard all this testimony and as they read it and so forth, and see which way they want to move. But I appreciate very much your candor, a variety of points of view, the honesty from your own experience that you have expressed, because, without that, why, we are simply flying blind. This is a group around this table who want to do good, but they really need information, and they need facts from people who are on the firing line.

Does anyone else have a comment? Yes, Sir?

Mr. PAUL. I just wanted to make one other comment, Senator. When we talk about this free trade idea, I don't believe we can ever expect that the European Union is going to absolutely give up their subsidies.

The CHAIRMAN. Maybe not.

Mr. PAUL. They are going to protect their farmers. And I think the point that was raised by the witness from Tennessee, this local supply has a great deal of truth to it because you are not only looking at a local supply of milk, you are dealing with the people that are involved in those areas and the impact those people have on that rural economy. As you said yourself, we are dealing with this rural development. What are we trying to do? We are trying to put dollars and people back in rural areas. There are people out there right now, and if we need to do something with the price of milk so that they can stay there and keep those local businesses, schools, and so on going, I think that is—we have got to look at a broader picture than just simply the price of milk.

The CHAIRMAN. Yes, Mr. Hinsdale?

Mr. HINSDALE. Just two brief things. One is I do believe that many of the services and functions that have been provided by milk marketing orders in that system will be taken over as the continued growth and development and consolidation and expansion of farmer-owned cooperatives. I think farmer-owned cooperatives are a very important mechanism in the dairy industry that will continue to become more important and make a lot of the Government program stuff less relevant.

The second observation in terms of the question of measuring equality or fairness and what that means, recognizing the geographical, environmental, and cultural diversities of our regions, I happen to come from the State that has the most dairy-dependent economy in the United States of America. Vermont is more dependent on the milk check than Kansas on wheat, Florida on citrus, or Indiana on corn. And all the value-added, whether it is your Ben and Jerry's or your Cabot cheese and the culture that works in companionship with that, our average community is less than 3,000 people and our average community has seven dairy farms. That is how intimate the relationship is.

So as we move forward with agricultural policy, there will be regional forms of agriculture, whether it is ethanol production or dairy production in the Northeast, where there are certain forms of agriculture that make a disproportionate contribution to the economy and the culture of the area, which is why people fight so hard for it. And what we need to find is to be able to allow in this United States of America different regions that have different industries that are key to their regions, to have the opportunity to have initiatives to develop those resources.

And I think that we need to do that, and I appreciate the opportunity to be here today.

The CHAIRMAN. Thank you.

You had your hand up, Mr. Brey.

Mr. BREY. Just as I don't come to Washington, DC., very often, and you ask a question and in my quick response sometimes I do have a slip of the tongue, and I did mean that the price support should be on all milk and should be capped. Whenever we go over 3-percent of domestic use, well, then it should be into the free market sense. And I base that on the fact that I did mention that milk in the previous 5-years was at $12.78, and we have cleared the market basically except for some small powder purchases. So why should we, when we are projected to be 3.5-billion pounds below domestic production because of need, why should we be sacrificing a $10 price for our milk?

Thank you.

The CHAIRMAN. Well, I appreciate that point. Obviously, we were in a hypothetical discussion of targeting. Now, you can't have it both ways. Either you target or you say all milk. And so you take Mr. Scarlett into your tent. Whereas, you had it a little bit excluded earlier on.

Well, I appreciate very much each of you for coming, some from very long distance and great inconvenience, but you have added immeasurably to our understanding and I think to our other colleagues.

So saying, the hearing is adjourned.

[Whereupon, at 12:29 p.m., the Committee was adjourned.]

APPENDIX

FEBRUARY 9, 2000

**Statement of Senator Tom Daschle before the
Senate Committee on Agriculture, Nutrition, and Forestry
Hearing on Dairy Policy
February 9, 2000**

Mr. Chairman. Thank you for convening this hearing to consider the problems facing dairy farmers and processors in today's economy. This hearing comes at an important time for America's dairy industry, which faces some of the lowest prices in recent memory.

The decisions this Congress makes regarding our national dairy policy are critically important to dairy producers in SD and across the country. It is vital that we develop a sustainable, national dairy policy that provides a fair and equitable safety net for all dairy producers across the country. It is equally important that we do this through a deliberative, inclusive process that includes a open and vigorous debate. I hope this hearing marks the beginning of an open, candid dialogue about our national dairy policy, and I look forward to Chairman Lugar's continued leadership in this issue. I want to thank the many witnesses who took time out of their busy schedules to testify here today.

I am opposed to the continuation or expansion of regional dairy compacts in this country because they are inherently divisive. Compacts clearly favor producers in one part of the country, at the expense of those in other regions. For example, the Compact has stimulated and increase in milk production in New England that has oversupplied the market and driven down milk prices for dairy producers outside the compact region. This is unfair. It creates unnecessary discord between different areas of the country and shifts the public policy debate away from a critical national focus. We need a comprehensive approach to diary policy that provides an adequate safety net for all dairy farmers, regardless of where their farm happens to be located.

The Northeast Dairy Compact creates a relatively high price floor with no payment limit structure. The result is a system that actually promotes consolidation in the dairy industry by disproportionately rewarding larger operations. The Northeast has been losing small producers at a much faster rate than larger producers since the compact went into effect. This is another indication that regional dairy compacts are not a comprehensive long-term solution to the challenges facing the diary industry.

The second problem with our current dairy policy is the federal milk marketing order pricing structure. As we all know, the current structure bases the price for fluid milk based on a farmer's distance from Eau Claire, Wisconsin. This system rewards producers in the rest of the country at the expense of those in the Upper Midwest.

The logic behind the original law was sound – to promote localized dairy production throughout the country and give all Americans the health benefits of fresh milk. At the time this system was developed, this was necessary because the technology of the day prevented fresh milk from being transported great distances. With today's technology and widespread localized dairy production throughout the country, that system is clearly obsolete.

I'd like to reiterate the recommendations of Wayne Bok, a dairy farmer from Geddes, SD, who testified before this Committee yesterday. He stated that our federal dairy policy needs to do three things:

1. Maintain an adequate price support system for dairy farmers
2. Protect our domestic milk markets
3. Manage the country's milk supply

These principles should guide us as we develop our national dairy policy. We should help all of America's family dairy farmers compete on a level playing field and remain independent, family-based entities.

I again commend the Chairman for holding these hearings, and I look forward to working with him to craft a sound new dairy policy that will ensure a bright and sustainable future for America's dairy industry.

TAMMY BALDWIN
2ND DISTRICT, WISCONSIN

BUDGET COMMITTEE

JUDICIARY COMMITTEE
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW

Congress of the United States
House of Representatives
Washington, DC 20515–4902

1020 LONGWORTH HOB
WASHINGTON, DC 20515
TEL.: (202) 225–2906
FAX: (202) 225–6942

10 E. DOTY, SUITE 405
MADISON, WI 53703
TEL.: (608) 258–9800
FAX: (608) 258–9808

Email: tammy.baldwin@mail.house.gov

Statement of the Honorable Tammy Baldwin

Dairy Policy Hearing
U.S. Senate Agriculture, Nutrition and Forestry Committee

February 9, 2000

Chairman Lugar, Ranking Member Harkin, and other Committee Members,

Thank you for allowing me to present testimony in support of dairy policy reform. I also want to extend a heartfelt thanks to Senator Herb Kohl who was instrumental in bringing attention to the plight of the Midwestern dairy farmer during last fall's budget battle, and for his work in achieving this two-day hearing on current dairy policy.

I represent Wisconsin's 2nd Congressional District, which is about one-third urban, one-third suburban, and one-third rural. Many of my rural constituents are dairy farmers. They are some of the most efficient dairy farmers in the world. They have to be. Because between the rock of the Northeast Dairy Compact and the hard place of the current Milk Market Order system, my dairy farmers receive the lowest price for their milk than any other dairy farmers in the country. They have lived under this unfair pricing system for more than 50 years, and Congress' back-door "consent" to the Northeast Dairy Compact a few years ago has added to their hardship, as artificially propped-up milk prices cause milk over-

production in New England which erodes demand for milk nationally. The current prices for milk are at the lowest they've been since 1978. Under these circumstances, my dairy farmers have to be highly efficient to even stay in business.

Many of my farmers simply can't make it. Wisconsin leads the nation in dairy farms that have gone out of business. Wisconsin has a proud tradition of small family farms, and those farms support the surrounding rural economy. When local farms go bankrupt, the community around the farm suffers economically as well.

My dairy producers do not want a handout, they just want a federal policy that is fair no matter where they produce their milk. Allow me to give you one example. It's the story of Dwayne and Janet. Dwayne and Janet and their family operate a family dairy farm in my congressional district. Dwayne's family has operated a dairy farm for over 100 years. Dwayne, Janet and their three sons work hard to manage their herd of cows. They don't have any employees and they certainly don't have any free time...they usually work 90 to 100 hours per week. They worry about

their future. Dwayne's been running the farm for 20 years. And in the last 20 years he has seen half of the dairy farmers in his township alone go out of business. Dwayne and Janet are worried about whether they will be able to stay in business, and to provide for their children.

Dwayne and his family don't want a hand out. All he and his family want is a level playing field. Dwayne knows that there are dairy farmers in other regions of the country are getting more for their milk. It's not that the milk produced in other areas is of a higher quality – it's only *the location of the farm where* the milk is produced that brings a higher price. Dwayne doesn't want to hurt other dairy farmers in the country -- he respects them because he knows very well how hard they work. But he doesn't understand Congress' reluctance to set a fair policy for all dairy farmers.

As we all know, the USDA, at the behest of Congress, tried to reform the milk market order system to become more fair to dairy producers like Dwayne and Janet. But during last year's budget fight at the end of the session, power politics won over simple fairness and the pricing reforms

were almost entirely killed.

I, along with the entire Wisconsin delegation, will continue to work toward fair pricing systems for my farmers. Even if we don't re-visit the pricing reform proposal of last year, it is my hope that this year Congress will look at policy changes that will help all of our farmers, including setting a decent base price for milk so that farmers can produce without losing money and allowing all dairy producers to enter into contracts with processors to lock in prices.

I look forward to working with Senators Kohl and Feingold, Governor Thompson, and the rest of the Wisconsin Congressional delegation to achieve what really is a simple matter of fairness.

Thank you for hearing my views.

STATEMENT OF KENNETH C. CLAYTON
ASSOCIATE ADMINISTRATOR
AGRICULTURAL MARKETING SERVICE
U.S. DEPARTMENT OF AGRICULTURE
BEFORE
THE SENATE COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY

February 9, 2000

Good morning, and thank you, Mr. Chairman, for the invitation to appear before the Committee to provide testimony on our progress in implementing changes to the Federal Milk Marketing Order Program. Accompanying me today is Richard McKee, Deputy Administrator, Dairy Programs, Agricultural Marketing Service.

Yesterday, Dr. Keith Collins, USDA's Chief Economist, offered testimony describing the overall situation and outlook for the U.S. dairy sector and our dairy farmers. Dr. Collins briefly touched on the role of the Federal order program within the larger constellation of dairy policy as well as actions taken to support dairy farmers' incomes. I will address the Federal milk marketing order program in a bit more detail. My remarks will briefly describe Federal milk marketing orders, the steps we have taken to meet the 1996 farm bill mandate, and the anticipated effects of milk order program changes on producers and consumers of dairy products.

Background

The Federal Milk Marketing Order program is intended to promote the orderly marketing of a highly perishable commodity, namely, milk. The Federal order program does so by helping to prevent marketplace behavior that might otherwise erode the price of milk at the farm gate and, ultimately, drive producers out of business. The significance of this protection, of course, depends on the relative bargaining positions of dairy farmers and those who purchase their milk. The number and size of processors bidding for producers' milk, the market strength of cooperatives selling milk on behalf of their producer members, and other factors come into play when assessing the respective bargaining positions of dairy farmers and processors.

Under Federal orders the proceeds from the sales of farmers' milk are pooled within a market area with an average value being returned to producers. The prices at which processors must account to a pool are based on the end value uses of milk. To allow pooling to work, a set of classified prices is established under Federal orders. These are **minimum** prices that processors must pay for milk corresponding to its value in several end product categories.

Class I or fluid milk generally earns the highest minimum price, because of supply and demand characteristics that tend to make fluid milk more valuable.

Class II products have lower minimum prices. Products covered include ice cream, yogurt, and the like -- the so-called "soft" dairy products.

Class III and Class IV manufactured dairy products -- including butter, dry milk products, and cheese -- have the lowest minimum prices. These products are traded in a national market and, because they are more easily stored than fluid milk or soft dairy products, they serve as the residual claimant for milk not needed for Class I or Class II products. It is these manufactured dairy product prices that provide the foundation to which differentials are added to determine the prices for Class I and II products.

As already noted, producers selling milk under a Federal order receive a uniform or weighted-average price, called the blend price, that reflects all of the uses of milk in a market area. Thus, all producers benefit from the higher price on milk that is marketed for fluid consumption. Likewise, all producers share in the lower prices for milk diverted to manufactured products. Equity is preserved with producers not needing to engage in behavior that may be contrary to their interests, such as bidding the price of their milk down to its manufacturing value, even though it may be used for fluid consumption. In this same vein, under Federal order pricing, handlers are unable to play producers against each other. As previously noted, the extent to which such behavior might actually occur would depend on the relative bargaining positions of dairy farmers and those to whom they sell their milk.

These market relationships are preserved with the revisions that have been made to the Federal order program. Minimum prices are still established according to a hierarchy of end product values. In complying with the mandate to make changes in the Federal milk order program, considerable care was taken to ensure the continued orderly marketing of milk in a manner that balances the various interests of producers, handlers, and consumers in the Nation's dairy market.

The Revision Process

Let me turn now to the process we undertook to achieve the Congressional mandate. First, Congress directed the Department to reduce the number of milk marketing order areas -- in essence, to redraw the geographic boundaries to reflect the larger marketing areas in which milk is now sold, distributed, and consumed. Second, Congress directed the Department to consider changes to the pricing structure utilized under the Federal order program. The system of classified prices was examined, as were the relative levels of Class I prices within and between milk marketing order areas.

From April 1996, until issuing a final decision on March 12, 1999, the Department worked closely with interested parties to revise the current program in a manner that would be beneficial to both dairy farmers and consumers. Throughout the process, the Department conducted extensive outreach efforts to educate interested parties regarding changes under consideration and continually solicited public input on all aspects of the program. As a result, more than 8,500 comments were received.

The final decision issued in March 1999 detailed the changes to the Federal milk order program. Basically, the program provided for 11 consolidated milk order areas, established a nationally coordinated Class I price structure that provided greater efficiencies in milk assembly and distribution, established new methods for pricing milk used for manufacturing purposes, made minor changes to the classification of milk provisions, and standardized various provisions, definitions, and terms across the orders.

The Department conducted extensive outreach efforts to ensure that dairy farmers were educated about the contents of the final decision. In August 1999, referenda were conducted to determine producer approval of the revised Federal milk marketing orders. Dairy farmers approved the 11 orders and a final rule implementing the consolidated program was issued on August 23, 1999. The revised orders were to become effective on October 1, 1999, in compliance with legislated mandates.

Several producer cooperatives contested in Federal Courts the implementation of the Class I price structure contained in the final decision. On September 28, 1999, a temporary restraining order was issued enjoining the Secretary from implementing the final rule revising Federal milk marketing orders.

On November 29, 1999, the Consolidated Appropriations Act, 2000, was signed which required that the revised orders become effective on January 1, 2000, utilizing the so-called option 1A Class I differentials contained in the proposed rule published on January 30, 1998, as corrected and modified through April 2, 1999. The Act further directed the Secretary to establish a forward contracting temporary pilot program and to hold a hearing on Class III and Class IV milk pricing formulas. The Department expects to issue a notice regarding the pilot program soon and we issued a notice on January 31, 2000, inviting proposals to be considered at a hearing on Class III and Class IV prices to be held later this year.

Finally, on January 1, 2000, the final rule consolidating and revising the Federal milk marketing order program became effective.

Expected Impacts on Dairy Farmers and Consumers.

I would now like to review the expected impacts of the revised Federal milk marketing order program on producers and consumers.

The Final Regulatory Impact Analysis that accompanied the Department's final decision assessed the economic effects of that decision as well as the so-called option 1A Class I differentials on dairy farmers, fluid milk processors, dairy product manufacturers, consumers, and USDA's food assistance programs.

Impacts under both sets of Class I prices were measured against the Department's national annual projection of supply, demand, and prices for milk and dairy products as adapted for the regulatory analysis. This baseline assumed: (1) the price support program would end on December 31, 1999; (2) the Dairy Export Incentive Program would continue; and (3) the Federal Milk Marketing Order Program would continue unchanged. National assumptions for the cost of milk production, especially feed, and the commercial utilization of milk and dairy products were adjusted to a regional basis.

Indicators chosen to gauge the economic effects of the revised Federal orders on dairy farmers and consumers included: 1) the all milk price (defined as the weighted-average minimum use value including Class I over order premiums); 2) farm cash receipts from milk marketings; 3) retail fluid milk prices; and 4) consumer expenditures on fluid milk and manufactured dairy products.

For purposes of the analysis, impacts were measured at 36 major pricing points. These included the 32 previously existing Federal order market areas (including the terminated Tennessee Valley order) and 4 non-Federally regulated areas (California, unregulated areas in the Western states, certain unregulated areas in New York and New England, and other unregulated areas in the Eastern states).

A summary table that compares the impacts of current (option 1A) differentials and the Department's final decision is attached as Table 1. It provides comparisons for both areas regulated under Federal orders and the overall United States.

Impact on Dairy Farmers

The all milk price across all Federal orders is expected to average less than $0.06 per hundredweight -- or about 0.4-percent -- higher under the current (option 1A) Class I differentials compared to those in USDA's final decision over the 2000-2005 period.

The all milk price at 16 of the previously existing Federal order pricing points is estimated to increase from $0.02 to $0.79 per hundredweight under the current Class I differentials. For the 16 other Federal order pricing points, the all milk price is estimated to decrease from less than $0.04 to $0.42 per hundredweight.

The six pricing points with the greatest average increase in the all milk price include: Denver at $0.79 per hundredweight; Oklahoma City at $0.44; Dallas at $0.42; and Knoxville, Charlotte and Philadelphia at $0.34. The five pricing points with the greatest reduction in the all milk price include: Miami at -$0.42 per hundredweight; Grand Junction (CO) at -$0.40; Peoria at -$0.39; and Des Moines and Omaha at -$0.35.

Under the current (option 1A) Class I differentials, the estimated annual gross cash receipts for all Federal order markets combined are expected to average $107.7 million – or about 0.6-percent – higher compared to what they would have been under the Department's final decision for the 2000-2005 period.

Gross cash receipts are expected to be higher at 16 of the previously existing Federal order pricing points compared to the Department's final decision. Average annual receipts for producers measured at the Dallas pricing point are estimated to increase $34.0 million; followed by New York at $29.7 million; Philadelphia at $29.2 million; Denver at $19.2 million, and Oklahoma City at $16.8 million.

Gross cash receipts from milk marketings measured at the other 16 pricing points are estimated to be lower during 2000-2005. The largest declines in cash receipts include: Chicago at -$28.8 million; Des Moines at -$11.6 million; Alton (IL) at -$7.2 million; Omaha at -$7.1 million; and Miami at -$7.0 million.

Impacts on Consumers

In general, changes in farm milk and wholesale product prices are passed through to consumers. However, the speed at which price changes are passed on to consumers continues to be a point of debate. It was assumed in the Final Regulatory Impact Analysis that all changes in fluid processor milk costs and wholesale manufactured dairy product costs would be passed through immediately to the retail level without any changes in processor-retail or wholesale-retail margins.

Accordingly, current (option 1A) Class I differentials are estimated to increase the average retail price of fluid milk across all Federal market order areas by $0.02 per gallon over the 2000-2005 period compared to the Department's final decision. Markets with the greatest average increase in retail price per gallon include: Denver at $0.08; Dallas at $0.07; Phoenix and Philadelphia at $0.06; and Oklahoma City and New York City at $0.05. Markets with a lower retail price per gallon include: Miami at -$0.04; and Grand Junction, Tampa, Peoria, Des Moines, Omaha, and Chicago at -$0.02.

Consumer expenditures on fluid milk products in all Federal market order areas combined are estimated to average $116.8 million per year higher under the current Class I differentials than under the Department's final decision. This is an increase of about 1.5 percent, given average annual consumer expenditures of $7.6 billion on fluid milk products in Federal market order areas.

Average annual consumer expenditures on manufactured dairy products across all Federal market order areas are estimated to decrease by $9.1 million per year compared to the Department's final decision. With average annual expenditures on manufactured dairy products totaling $9.3 billion, this amounts to a savings of about 0.1 percent.

Closing

Mr. Chairman, this concludes my statement. I will be happy to answer any questions the Committee may have. Thank you.

Table 1:

Comparisons of Selected Items Between Current (Option 1A) and USDA's Final Decision

Item	Unit:	Baseline	Current (OPTION 1A) Minus Baseline	Final Decision Minus Baseline	Current minus Final Decision	
					Per cwt	Per gallon
All Federal Order Markets						
Class I Differential	per cwt	$2.56	$0.04	($0.29)	$0.33	0.028
All Milk Price	per cwt	$15.23	$0.03	($0.02)	$0.05	—
Class I Price	per cwt	$16.22	$0.08	($0.19)	$0.27	0.023
Class II Price	per cwt	$13.95	$0.43	$0.50	($0.07)	—
Class III Price	per cwt	$13.65	($0.04)	$0.01	($0.05)	—
Class IV Price	per cwt	$13.76	($0.07)	$0.00	($0.07)	—
Cash Receipts	million	$16,945	$104.9	($2.8)	$107.7	—
Fluid Expenditures	million	$7,618	$36.4	($80.4)	$116.8	—
Manufacturing Expenditures	million	$9,327	$68.5	$77.6	($9.1)	—
Milk Marketings	mil lbs	111,182	149.0	8.0	141.0	—
Class I use	mil lbs	46,956	(16.6)	42.1	(58.7)	—
Manufacturing use	mil lbs	64,226	165.6	(34.1)	199.7	—
United States						
All Milk Price	per cwt	$14.73	$0.04	$0.00	$0.04	—
Class I Price	per cwt	$16.26	$0.06	($0.15)	$0.21	0.018
Milk Marketings	mil lbs	165,142	128.7	14.8	113.9	—
Class I Use	mil lbs	58,782	-14.9	37.8	-52.7	—
Manufacturing Use	mil lbs	106,360	143.6	-23.0	166.6	—
Cash Receipts	million	24,347	77.0	3.2	73.8	—
Fluid Expenditures	million	9,562	31.3	-79.3	110.6	—
Manufacturing Expenditures	million	14,785	45.7	82.5	-36.8	—

CFA Consumer Federation of America

STATEMENT OF
ARTHUR S. JAEGER
ASSISTANT DIRECTOR

BEFORE THE
SENATE COMMITTEE ON AGRICULTURE,
NUTRITION & FORESTRY

ON CONSUMERS AND THE
FEDERAL DAIRY PROGRAM

WEDNESDAY, FEBRUARY 9, 2000
WASHINGTON, DC

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121 • www.consumerfed.org

STATEMENT OF ARTHUR S. JAEGER
ASSISTANT DIRECTOR
CONSUMER FEDERATION OF AMERICA
ON CONSUMERS AND THE FEDERAL DAIRY PROGRAM
WEDNESDAY, FEBRUARY 9, 2000
WASHINGTON, DC

My name is Art Jaeger. I am pleased to be here today on behalf of the Consumer Federation of America.[1] This Committee should be commended for holding these hearings in the wake of last year's floor debate over the Northeast Dairy Compact. There are better ways to keep small farmers on their land than increasing the price of milk to consumers through compacts.

The Consumer Federation of America has several overriding concerns when it comes to farm programs. Most importantly, we dislike price support programs that raise the price of food to consumers in the name of helping farmers. Typically, these programs use limits on production, limits on imports, and artificial increases in commodity prices to boost farm income. Unfortunately, much or all of this increased farm income is passed on to consumers as an added cost by those who buy commodities from farmers—that is, processors and retailers. We may not like it, but it's economic reality. Consumers pick up the tab. It amounts to a substantial income transfer from consumers to farmers.

CFA's opposition to price support programs doesn't mean we are unconcerned about the future of small family farms. On the contrary, the continuing decline in the number of small farms, dairy and otherwise, is a major concern. Small farms add much to the economic and social fabric of the nation and should be preserved. We simply don't feel price support programs are an acceptable way to do this.[2]

These core beliefs have prompted the Consumer Federation of America for many years to oppose the federal sugar program, which increases the cost of refined sugar and processed foods to consumers while providing the bulk of its benefits to wealthy Florida

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[1] The Consumer Federation of America is a nonprofit association of more than 260 pro-consumer organizations, most of them national, state and local advocacy organizations and consumer-owned nonprofit cooperatives, such as credit unions and housing co-ops. These groups have a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer interest through advocacy and education. CFA's positions are developed and voted on by its member organizations at annual meetings.

[2] Repeatedly in the last year, as economic conditions in rural America deteriorated, CFA raised the possibility of a means-tested program to save the remaining family farms. A recent Economic Research Service analysis hints at the same solution. It looked at four approaches to a "farm household safety net." Three of the four approaches were based on income or expenditure thresholds used in other federal assistance programs. The fourth used a minimum standard of living approach. The analysis found that these safety nets would cost about as much as current farm programs. But the distribution of benefits changed dramatically. Under the safety nets, a much larger percrentage of benefits went to smaller farms or those with limited resources.

cane growers. CFA has opposed the federal peanut program on similar grounds.

These beliefs have also caused us to oppose both the antiquated federal milk marketing order system and interstate dairy compacts.[3] In our view, neither is in the best interest of consumers or small producers. Because they base benefits on gallons of milk produced, these programs give too much money to farmers who don't need help and too little money to farmers who do need help. And, once again, they ask consumers to foot the bill.

Milk Marketing Orders

The 1996 farm bill offered the promise of long overdue, pro-consumer reforms in the milk pricing provisions of the federal dairy program. Most importantly, the farm bill ordered the Agriculture Department to reform the Depression-era system of price premiums paid to farmers for beverage milk. The cost of these premiums, like other aspects of price support programs, tend to be passed on to consumers.

The Consumer Federation of America was disappointed the plan devised by the Agriculture Department didn't go further in reducing or eliminating these differentials. Nonetheless, the Agriculture Department's "final rule" was a step in right direction. It benefitted consumers by reducing many differentials. By taking into account modern refrigeration and transportation systems, it began to modernize the archaic federal milk pricing system.

Unfortunately, even this modest reform disappeared with enactment of H.R. 1402 in the closing days of the 1999 session. H.R. 1402 made changes that mostly moved in the wrong direction—toward higher retail milk prices. By substituting so-called "Option 1-A" for USDA's final rule, the bill increased the farm price of milk in most states. Consumers will end up paying for some or all of those increases, as processors and retailers pass their increased costs onto their customers.

CFA estimated the annual cost to consumers of Option 1-A versus the final rule to be as much as $200 million. That was based on USDA estimates that the final rule would save consumers nationwide an average of two cents per gallon of milk and Option 1-A would cost consumers about a penny a gallon. In general, the biggest losers under Option 1-A were consumers in the Northeast and South. Conversely, farmers in those regions are among the biggest winners.

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[3] We have been joined in this by other consumer and low-income advocacy groups, including Consumers Union and the Center on Budget and Policy Priorities.

Dairy Compacts

Compacts are regional milk pricing agreements designed to further boost income for dairy farmers. They allow a regional commission to set a price paid to farmers for milk that is above the price set under the federal marketing order system. This so-called "over-order price" is now $16.94 per hundred pounds of milk under the two-and-a-half-year-old Northeast Dairy Compact. Under law, this price could be raised to nearly $23.

The Northeast compact clearly has provided additional income for New England dairy farmers. But it has also triggered substantially higher milk prices for consumers. As with Option 1-A, some or all of the higher price for raw milk received by New England dairy farmers under the compact is passed along as an added cost by processors and retailers. This pass-through began immediately after the Northeast compact went into effect in July 1997. Initially, New England milk prices rose 15 to 20 cents per gallon. Record high prices later muted the impact of the compact, as the gap between the federal support price and the compact price narrowed. Still, taking into account fluctuations in the federal price and assuming a 100 percent pass-through, CFA calculates the cost of the compact to consumers through January to be $88 million, or an average of 15 cents per gallon of milk sold.

A recent study commissioned by the compact's own governing body confirms that the compact is having a substantial impact on New England consumers. The study, by economists at the University of Massachusetts, Amherst, examined milk prices in the first year under the compact.[4] It found that retail milk prices do rise and fall with the farm price of milk and that a substantial portion of the increase in the farm price of milk under the compact is passed on to consumers. The study found a 70 percent pass-through in Boston and more than a 40 percent pass-through in Hartford. The study concluded that, in its first year, the compact increased milk prices an average of nearly seven cents per gallon in Boston and nearly six cents per gallon in Hartford.[5]

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[4] The UMass study is based on an economic model constructed by the authors, using 14 years of farm and retail milk price changes. The study focuses on Boston and Hartford because retail price data for those two cities is available from the Agriculture Department's Agricultural Marketing Service. The study is dated October 1999 but was not available until after Congress adjourned for the year. Before adjourning, Congress extended the Northeast compact, which had been scheduled to sunset in October 1999, for two more years. Congress resisted pressure to expand the Northeast compact to other states or to establish an even larger Southern Dairy Compact.

[5] The UMass study's impacts clearly are lower than those calculated by compact opponents. Two factors could account for this. First, the UMass study looked only at the first 12 months of the compact. It did not take into account a large drop in the basic federal price for milk in early 1999. Had it been extended to the compact's second year, the UMass study could well have found a much larger consumer impact. The second factor is the UMass study's partial pass-though of compact-related increases in the farm price of milk. Opponent assume a full pass-though of farm price increases. The UMass study's finding of a partial pass-through is contradicted by another recent study, this one by the Food Marketing Policy Center at the University of Connecticut. The UConn study concluded that, in the Northeast at least, increases in the farm price of milk are fully passed on to the consumer at the retail level. Had the UMass study found a greater consumer pass-through and had it looked at two years under

Supporters of the compact cite its success in "stabilizing" milk prices in New England. More accurately, the compact puts a floor under prices. In the UMass study, those floors were approximately $2.60 per gallon in Boston and nearly $2.70 per gallon in Hartford. That means retail prices tend to stay at or above those levels regardless of what happens to the underlying federal price. When market forces and the federal system combine to push prices above the compact floor, consumers in the compact region pay more for milk. When market forces and the federal system combine to push prices below the compact floor, consumers in the compact region don't necessarily pay less.

Between November 1999 and January 2000, the basic federal price to farmers for milk plunged, from $16.26 to $10.90 per hundred pounds of milk. That's good news for consumers in most areas, who should be seeing lower milk prices soon. But that can't happen in New England. There the farm price for milk would be $14.14[6] except for the compact, which keeps the price at $16.94. That translates to an added per-gallon cost this month alone of 24 cents, assuming a full pass-through. That's a cost New England consumers wouldn't be there except for the Northeast compact.

Effects on Low-Income Families and Milk Consumption

Higher retail milk prices under both Option 1-A and the Northeast compact will hurt low-income consumers more than most because they spend more of their income on dairy products than other families. Bureau of Labor Statistics data indicate that, as a percentage of income, the poorest fifth of families spends three times as much on dairy products as the average family. Likewise, as a percentage of income, the poorest fifth of families spends six times as much on dairy products as the richest fifth.

Higher milk prices under Option 1-A and the Northeast compact will also result in some decrease in milk consumption. USDA concluded that the final rule, by lowering milk prices in most states, would increase milk consumption by 4 million gallons a year. By raising milk prices, both the Northeast compact and Option 1-A can be expected to decrease milk consumption. A University of Missouri study concluded that every 10 percent increase in milk prices causes at least a 3.2 percent decrease in milk sales. Industry data indicate milk consumption declined about one and a half percent in New England in the first year under the compact.

A slight decline in milk consumption may seem trivial...but the public health effects may not be. Milk is an excellent source of calcium, yet three out of four Americans do not get

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the compact instead of one, its estimated consumer impacts would have been much closer to those cited by compact opponents.

[6] That is, $10.90 per hundredweight plus the Boston-area differential of $3.24.

enough of it. The National Academy of Sciences recommends that all Americans, especially children and the elderly, increase their consumption of calcium. Milk consumption has fallen steadily over the last 20 years—from more than 240 pounds per capita in 1977 to less than 210 pounds in 1997. USDA data indicate that, on average, teenagers only drink enough milk to receive a quarter of the recommended 1300 milligrams of calcium a day. Raising the price of milk will make it that much harder to turn this situation around.

Both Option 1-A and the Northeast compact are also increasing the cost of federal nutrition programs. A USDA analysis indicated that, for the four major nutrition programs, Option 1-A would increase costs nearly $10 million per year, while the final rule would have decreased costs more than $20 million a year. That's a total difference of approximately $30 million per year, with food stamps hit the hardest. The Northeast compact commission has tried to insulate WIC and the school lunch program from compact-related retail milk price increases. But it can do nothing about food stamps, the largest of the federal nutrition programs. The extra dollars food stamp recipients spend on milk under the compact aren't available to purchase other items a low-income family needs. This is referred to as lost purchasing power. CFA calculates the loss of purchasing power in New England thus far under the compact to be $9 million.[7]

Helping Small Farmers

Supporters of Option 1-A and compacts say they are needed to shore up financially struggling family dairy farmers. But permanently raising the price of milk for most consumers is not an efficient response to the dwindling number of small family farmers in this country.

First, not all dairy farmers are in trouble. Nationwide, dairy farmers saw the highest average milk prices on record in 1998 and 1999.[8] This is in marked contrast to other farm sectors. At the same time, feed prices—the major cost for dairy producers—were at some of the lowest levels ever.

The farmers who *are* struggling tend to be small. According to the Census of Agriculture, since 1982, three out of four dairies going out of business in the Northeast, Mid-Atlantic and South had less than 50 cows.

Changes in raw milk prices under Option 1-A and the Northeast compact increase income on a per-gallon basis. So farmers benefit based on their total production,

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[7] Based on average per capita milk consumption of 37 gallons per year (from USDA's Thrifty Food Plan), roughly 850,000 New England food stamp recipients, and a full pass-through.

[8] The base price farmers receive for milk hit $17.34 per hundredweight in December 1998 and $16.27 per hundredweight in January 1999.

regardless of their income or economic condition. That means those with the most production get the most benefit. This gives enormous subsidies to those who least need it...the largest dairy farms. Some of these farms have net worths ranging from $1 million to $5 million. Conversely, the smallest farms, with fewer cows and less production, get the least benefit from a per-gallon price increase. They receive only a small proportion of the total subsidy. In most cases, it is not enough to ensure their survival.

Let's look at some examples from New England, based on Census of Agriculture average production numbers by farm size. Under the compact, the smallest dairy producers, those with less than 20 cows, should have received an average of $680 from the compact for 1999. At the other end of the scale, dairies with 200 to 500 cows should have received an average benefit of $30,800 per farm. Those with more than 500 cows should have received an average of $70,500.

Imagine if food stamps were awarded on a similar basis...the more you earned, the more food stamps you received. Does that make for an effective assistance program? We don't think so. Likewise, raising milk prices across the board is an inefficient way to assist that portion of dairy farmers who are in trouble.

Large payments received by large producers also help widen the competitive gap between large and small dairy farmers. The additional income allows large producers to make investments that further boost their production and allow them to become more efficient. This, in turn, helps them take more of the market away from the smaller dairies. Put another way, contrary to the stated intent, the result of these programs may be that big dairy operations get even bigger while more small and mid-sized dairies go out of business.

When he authorized the Northeast compact, Secretary Glickman was careful *not* to say the compact would solve the problem of declining dairy farms in New England. He noted that the decline in the number of dairy farms since 1990 had actually been *less* in New England than the national average. He conceded the compact would provide a benefit to New England dairy producers but added that this benefit would be "in direct proportion to their size." He then said the higher prices New England dairy producers would receive under the compact would be unlikely to change "the long-term trend toward larger and probably fewer dairy operations" in the region.

Changes in the number of dairy farms in New England suggest Secretary Glickman was correct. According to the American Farm Bureau Federation, in the two years before the compact went into effect, New England lost 283—or eight percent—of its dairy farms. In the two years after the compact took effect, New England lost 10 fewer farms. But in percentage terms, the loss was actually slightly more—8.4 percent. Clearly, Secretary Glickman was right to say the compact would probably not reverse the decline in the number of New England dairies.

Consumers did pay dearly, however, to keep those 10 New England dairies in business. Based on an estimated two-year cost of the compact of $65 million, consumers paid $6.5 million in higher milk costs for each "saved" New England dairy.

Conclusion

To sum up, both compacts and Option 1-A increase the price of milk to consumers, especially low income consumers, and decrease milk consumption. At the same time, there is no evidence either of these efforts will save many small family dairy farms. In fact, since the greatest proportion of the benefits go to the larger farms, they may have the opposite effect.

Congress would be better off to enact a targeted assistance package for those small dairy farmers needing help to survive. This would be more effective, and probably cheaper...and it would target assistance where it's needed, not on those who are doing fine. While such a dairy aid package would entail some government cost, at least taxpayers would know they were not providing cash subsidies to farmers who don't need them.

In each of the last two years, Congress approved emergency farm aid packages that included assistance to dairy farmers. And just last week, the Clinton Administration unveiled a two-year, $11 billion proposal to help farmers struggling in the current slump. The Consumer Federation of America does not agree with everything in the Administration package. But well-targeted assistance programs are better for both consumers and small farmers than compacts or Option 1-A.

Mark Furth
Testimony Before the Senate Agriculture Committee
February 9, 2000

On behalf of the 6,500 dairy producers of Associated Milk Producers Incorporated, a Midwest dairy cooperative, I want to thank you Chairman Lugar and other members of this committee for allowing me to participate in the hearing.

I am Mark Furth, CEO and general manager of AMPI. In my 30 years of work with dairy farmers and milk pricing, I have seen some things change very little and others change substantially.

Some of the major changes significant to milk pricing, are:
1) Cooperatives now market almost all farm production.
2) National production has dramatically shifted to the West.
3) Transportation is no longer a major inhibition to marketing.
4) Quality and refrigeration have improved to make milk less perishable.
5) Major usage has shifted from bottled milk to cheese - which now accounts for the lion's share of milk production.
6) Markets are no longer local - today, markets for all products are national.

Through all of this change, two major federal programs remain the same: federal milk marketing orders and price supports. They must be either very good pieces of regulation or very overdue for dismantling. That question should drive our consideration of future federal dairy policy.

Although these two programs are over 50 years old, they have both changed direction since the early '80s. Price supports have been sharply lowered and now provide only a limited safety net for U.S. dairy farmers.

Meanwhile, support for some regions of the country has actually increased. Specifically, through federal marketing orders and more recently, compacts, Class I fluid prices have been increased, giving price relief to farmers with higher Class I utilization and the benefit of federal price control. While we've lowered the safety net on a national scale, we've actually added new price guarantees for some areas.

To make this discrimination worse, reliable economic studies by the likes of USDA, FAPRI and Cornell show that relatively higher supports for some, actually lower prices for other dairy producers.

Dairy is a national market today with supply/demand setting the price and balancing the market for most products. Class I fluid use is a rapidly shrinking part of total production and an increasingly ineffective and unfair vehicle for supporting prices for U.S. dairy farmers.

Meanwhile, the U.S. is a very attractive market for the world. Without an import tariff-rate quota system, we would be a magnet for any surplus production around the world. If U.S. trade policy lowers import restrictions without leveling the playing field, those regions without the safety net of higher Class I prices or compacts will be sacrificed. I trust you won't let that happen.

We need a national dairy pricing system and a national dairy policy without regional distortions. I believe recently legislated federal order > changes and the Northeast Compact extension have further distorted our U.S. pricing system. How can Congress in good conscience consider international dairy policy until it first ensures a fair domestic pricing system for U.S.dairy farmers.

As you consider another Farm Bill, I propose the elimination of federal orders and compacts as poor policies that help some dairy farmers at the expense of others. I propose a strengthened national price support program to help all dairy farmers.

An effective national pricing system should include the pooling of all benefits and costs across our nation and a two-tier pricing mechanism that provides disincentive to increase production in the face of a price-depressing surplus.

I hope this committee can reclaim jurisdiction over these issues. Your decisions will have a huge influence on the health of our industry for decades to come. Please ensure that dairy is a strong, healthy and prosperous part of American agriculture. Give us a national policy - not a patchwork of regional manipulations.

When the ever-famous Titanic set to sea, there was great confidence that new technology and new markets were unbeatable. The Titanic was so unsinkable that it provided life boats for less than half the passengers. You know the rest of the story.

As dairy sets to sea in a world market, it would be over-confident to eliminate price supports and import quotas. The safety net of federal orders and compacts would save far too few dairy farmers.

Not only would we be short of life boats - but have pre-assigned seating besides.

Regional dairy policies must go. Our great industry and great nation deserve better.

Chairman Lugar and committee members, thank you for the opportunity to testify. The dairy farmers of AMPI have great confidence in your ability to craft effective 21st century dairy policy.

Testimony of James Vanblarcom

before the United States Senate Agriculture,

Nutrition and Forestry Committee

Regarding Federal Dairy Policy

February 9, 2000

Good morning, my name is James Vanblarcom, and I am a dairy producer from Northeastern Pennsylvania in Bradford County. My family and I manage a one hundred cow dairy that we have owned and operated since 1974. I'm also very actively involved in agricultural leadership responsibilities off the farm serving as President of the Bradford /Sullivan County Farm Bureau, and I am a member of Pennsylvania Farm Bureau's State Dairy Committee. I want to thank the Committee for providing the opportunity for me to give you a brief Pennsylvania producer's perspective on how national dairy policy has been effecting my operation and the Pennsylvania dairy industry as a whole.

Agriculture is Pennsylvania's leading industry and dairy is the leading segment of that industry. The economic impact of the Pennsylvania dairy industry is huge. The total value of milk produced in the state amounted to 1.73 billion dollars in 1998. We are the fourth leading dairy producing state in the nation. While Pennsylvania's dairy industry continues to maintain a slow rate of growth in total milk production through greater producer efficiencies, our dairy farm numbers, cow numbers, and total market share of the nation's dairy production continues to shrink. We have approximately 9,900 dairy farms in Pennsylvania producing 10.8 billion pounds of milk. The trend in consolidation of dairy producers has been consistently reducing dairy farm numbers 300-500, or more, per year for the past decade. In fact, about 30 percent of the state's dairy farmers have gone out of existence in the decade of the nineties. At the same time the average Pennsylvania dairymen has increased milk production per cow about twenty-percent.

I began as a dairy producer at a time when technological advances in production agriculture began to push productivity of individual farmers to levels never imagined. Dairy farmers knew about what the price of milk was going to be not only next month, but even next year. Our milk prices were held steady by a government support price that bought dairy products when inventories were high and sold when inventories were low. Meanwhile, producers like myself continued to adopt new technology and management skills that produced milk more efficiently. As production levels rose along with production costs, federal dairy policy provided us with even higher support levels until government purchases grew well beyond manageable levels. Media attention to the issue aroused tax payer's concerns. That brought a change in federal dairy policy that has had a profound effect on every dairy producer in the nation.

Since that time, federal dairy policy has driven the industry much closer to milk prices being established by national marketing conditions. The difference this has made in my dairy operation overall has been dramatic and many times even traumatic. Milk price volatility has made maintaining an economically viable operation a real challenge. Price swings of thirty to forty-percent from one month to the next have become common in the past few years. I challenge anyone to run a business with the level of volatility dairy producers have been experiencing in the price they receive for their product. Current milk marketing conditions are likely to keep producer prices low through most of this year and possibly longer.

My brother who farms next door operates a 120 cow dairy. We share farm equipment and labor during planting and harvesting seasons. In this cooperative effort, we cut our expenses. We are both hard working, experienced, and knowledgeable dairy producers. My brother and I are ranked third and fourth in milk production per cow in Bradford County, which is the third largest milk producing county in the state. Even with our best management practices, stockholders would view our present dairy operations as a poor investment due to the lack of financial performance. I have three children, all of which have some varying interest in agriculture. They have witnessed the struggle and the unpredictability of the dairy industry firsthand. Under present conditions, I would understand their decision not to pursue dairy farming as a career.

Federal milk marketing orders are designed to protect minimum prices for producers that will provide for a reliable and fresh supply of milk for the consumer. If the current pricing system and trends continue into the future, we can not count on a reliable fresh supply of milk in all areas of the United States.

The dairymen in the Northeast and upper Midwest are slowly losing their ability to compete. Milk production is shifting to the West, (see chart # 1 regional milk production). This chart shows that the percentage of milk produced in the Southwest, West and California has more than doubled from 1970 to 1997. Southwestern dairymen have lower costs due to their ability to store feed and house animals outside. Many areas of the Southwest use taxpayer subsidized water supplies for irrigating animal feed crops and watering cattle. Traditional dairy areas need more expensive buildings for feed and cows. This shift to the West will eventually deplete our dairy industry in Pennsylvania to a level where it can not adequately supply fresh milk to consumers in the North and Northeast. There will still be plenty of milk but not in the right location.

The trends of westward and larger dairies would be all well and good, if your only need is cheap milk. However numerous consumer concerns come to mind. They are the environmental issues created by very large dairies and future competition for water in the and western areas. Also an issue, the lack of milk producers in proximity to high population centers of the North and Northeast. Over 2 5 % of the United States' population live within a three or four hour truck drive of New York and Pennsylvania dairy farms. Just imagine how today's diesel fuel prices would affect the cost of California milk in New York City.

The dairy industry in Pennsylvania, New York, and Wisconsin are the agricultural backbone of each state. Dairy farms provide hundreds of million of dollars to the economic activity to each state. The loss of these farms will be felt in the rural, urban and metro areas and all of the governing taxing bodies within the region.

Tourism depends on dairy farms in many areas for the beauty and tranquillity of cows grazing, open fields, rows of corn and farmsteads. When dairy farms fail many times they are sub divided into small plots or large home lots which can never again contribute to the production of food or enhance tourism. Many areas of this region are ideally suited to the dairy cow. Climate is right and milk can be produced in a environmentally safe manner. A dairy cows diet contains a high percentage of forages and other food processing byproducts, which can not be used for human consumption. These forages are grown in soils that many times can not produce human consumable crops profitably.

The world now has six billion people. In the future when the food process system is straining to keep up with our needs for weather, disease, or political reasons, the consumers of this region will be thankful for our dairy farms. That is if we have the foresight to save our dairy farms. Today many people take their food supply for granted because it has always been there. Will it always be there?

I am sure this committee is concerned about nutritional issues as well. Chart #2 will remind you of the quality of this product. This chart compares two of the common beverages that Americans drink. Federal nutritional policies should help encourage higher milk Consumption, particularly in our schools.

What dairy policy changes can be made to address the current challenges I as well as other producers face? First, let me say thank you as a producer for the action that was taken by Congress last year to address producer concerns with the federal milk marketing order reforms. With the positive action taken on Option 1a Class I milk pricing differentials and extension of milk price supports for another year at the current level, combined with component pricing that allows the higher of Class III or IV to be used for the Class I price mover, we have avoided an even more disastrous scenario on producer prices than we are already experiencing.

Pennsylvania has a state milk pricing agency that establishes minimum producer, wholesale and retail prices. While the Pennsylvania Milk Marketing Board has been able to provide an over-order premium at various levels on Class I milk to help address producer price needs, the benefit to many of Pennsylvania's producers, including myself, has been very limited by interstate commerce law and the lack of market-wide distribution of the premium to producers. Dairymen have lost twenty, percent of their share of the retail dollar since 1980, (see chart # 3). I believe a regional approach to milk pricing is a better method of helping to stabilize producer prices and address producer price needs affected by local marketing conditions. If properly administered, we now know dairy compact pricing can bring benefits to producers at little, if any, cost to consumers, and with no impact on national marketing conditions. It is my understanding that you have heard, or will hear testimony regarding the positive impact the Northeast Dairy Compact has had on dairy producers in that region, while having no impact on the rest of the industry. I believe future national dairy policy should allow for the expansion of dairy compacts.

It is also imperative that Congress support continuation of the milk price support program at its current level. This level helps maintain a floor on producer prices, but at a level far below any level that would stimulate over-production. As we meet here today, producer prices are touching that floor price. I suspect some government purchases will be made before we get through the current marketing conditions. However, the last report I read indicated there were no government purchases of cheese to date, even though prices are at the support level. Without some safety-net for producer prices, I believe we will needlessly lose many dairy producers who will be needed to provide adequate milk supplies when the productivity climate is not as favorable.

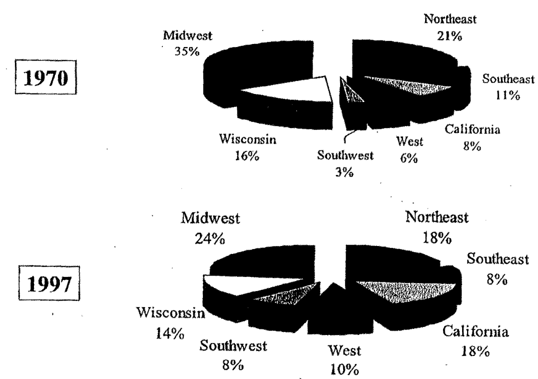
Anything that can be done to provide better safety-nets for dairy producers without significantly distorting the national marketplace and the potential for the international marketplace should be done. However, as long as the European Union continues to subsidize their export markets we cannot afford to unilaterally disarm our dairy producers against subsidization of export markets. The Dairy Export Incentive Program should be fully funded to help maintain our presence in the international marketplace.

Revenue insurance products should be developed for dairy producers. Current pilot gross revenue insurance programs disqualify producers who have greater than 35 percent of there gross income coming from livestock. That needs to change! Some would point to dairy options on milk pricing futures as method of providing revenue insurance for dairy producers. Unfortunately, this market is off to a slow start with little trading activity, especially in this time of depressed milk prices. It will take time for this risk management tool to mature into a viable option, but nonetheless I hope it succeeds.

Tax free savings provisions for farmers would be an excellent tool to provide dairy producers a better way to manage price volatility. Farm and Ranch Risk Management Accounts (FARRM) were passed by Congress in the tax cut package that the President vetoed last year. FARRM accounts would encourage producers to save money during a year of higher milk prices to be used in times of lower milk prices. Current tax provisions only encourage producers to spend money when they make it to avoid paying taxes, and then we have no liquid assets when leaner times come along. We need immediate, complete, retroactive, deductibility of heath insurance for family farms. We are about half through a seven year phase in program. I paid $5,071 for health insurance and only about half is tax deductible. Of course, the other tax provisions contained in last years package, which included the estate tax elimination and capitol gains reductions, would greatly benefit the future of the dairy industry.

#1

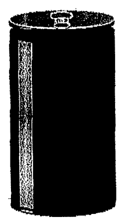
Regional Milk Production
1970 vs. 1997



BATTLE OF THE BEVERAGE

Teens drink three times more soft drinks than milk, but when it comes to nutrition, not all drinks are created equal. Check out how the average diet cola measures up to a glass of fat free skim milk.

(1 cup serving)



DIET COLA

1 calorie
0 fat grams

Protein	<1%
Calcium	<1%
Potassium	<1%
Riboflavin	<1%
Niacin	0%
Vitamin A	0%
Vitamin B-12	0%
Vitamin D	0%
Phosphorus	2%

(1 cup serving)

Fortified with Vitamin D

FAT FREE SKIM MILK

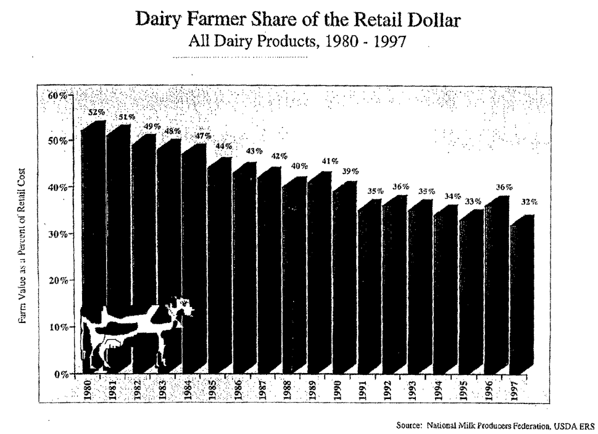
90 calories
0 fat grams

Protein	16%
Calcium	30%
Potassium	11%
Riboflavin	24%
Niacin	10%
Vitamin A	10%
Vitamin B-12	13%
Vitamin D	25%
Phosphorus	20%

Developed by: Milk Processor Education Program

*All percentages reflect daily values (DV) based on a 2,000 calorie diet

#3


Dairy Farmer Share of the Retail Dollar
All Dairy Products, 1980 - 1997
Farm Value as a Percent of Retail Cost
60%
50%
40%
30%
20%
10%
0%
52%
51%
49%
48%
47%
44%
43%
42%
40%
41%
39%
35%
36%
35%
34%
33%
36%
32%
1980
1981
1982
1983
1984
1985
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1987
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Source: National Milk Producers Federation, USDA ERS

The Alliance
of Western Milk Producers

Testimony before
Senate Committee on Agriculture, Nutrition & Forestry
Wednesday, February 9, 2000
on
Dairy Policy
by
Jim Tillison
Alliance of Western Milk Producers

1225 H Street, Suite 102, Sacramento, CA 95814
Phone: (916) 447-9941 Fax: (916) 447-9942

Chairman Lugar, members of the committee, I am Jim Tillison, Executive Vice President and CEO of the Alliance of Western Milk Producers. The Alliance was formed in 1991 to represent the interests of California dairy cooperatives and the milk producers who own these cooperatives. I am testifying on their behalf and appreciate being given this opportunity to talk with you about dairy policy.

I will cover three areas of interest to the Alliance today – the dairy support program, international trade and provide a brief description of California milk pricing and how it interfaces with the federal milk pricing system.

The Dairy Support Program

Few government programs have been as effective as the dairy price support program. Started in 1949, the dairy price support program removes excess milk from the marketplace in the form of butter, nonfat powder and cheddar cheese. When demand is up, these products are released back into the marketplace. In this way, the program assures consumers that milk and dairy products will be available by assuring dairy farmers of a market of last resort.

In 1996, milk producers reluctantly agreed to the phasing out the dairy price support program. At that time, it was believed that the General Agreement on Trade and Tariffs (GATT) would present additional opportunities for dairy exports. Unfortunately, that has not been the case.

Top dairy cooperative economists from around the country met in January 1999 to evaluate the impact on producer income should the dairy support program end. It was estimated that the average producer milk price would drop $1.50 to $1.75 per hundred pounds of milk. This would result from domestic nonfat powder prices falling an average of 25 cents per pound. The total cost to dairy farmers nationwide was estimated at approximately $2.7 billion.

Because of this, the Alliance decided to seek an extension of the dairy support program through the full term of the 1996 Farm Bill. As you know, dairy was the only commodity which would have lost its program before the end of the farm bill. We were successful in gaining an extension through this year and are hopeful Congress will keep the program in place through the full term of the farm bill at least at the current $9.90 level.

The Alliance believes that a program that allows management of supply relative to demand, like the dairy price support program, is far superior to programs that offer producers income supplements. First, a support type program is market oriented. It provides a market for milk products at times of supply exceeding market demand and makes dairy commodities available when market demand challenges the supplies available.

Second, supplemental income programs are very costly. In the past two years, the Congress has approved $325 million in emergency income relief to milk producers. In 1999, $200 million was distributed based on 1998 milk production with a maximum check of $5,000. USDA estimates the cost of extending the support program at $300 million total for 2001 and 2002. However, the return on that $300 million will be over $2 billion to all dairy farmers proportionately. This is a far superior return on investment with benefits to both producers and consumers.

The Alliance has already begun working with other dairy producer organizations to explore possible alternatives to the support program that will provide the same benefit to all parties involved at such a reasonable cost. We hope one can be found as effective and market oriented as the dairy support program.

International Trade

Frankly, the Alliance's member cooperatives have significant concerns about the near term prospects for increased exports of dairy products. They believe that the U.S. dairy industry came out on the very short end of the stick in the GATT negotiations. While the United States' ability to subsidize exports has been dramatically reduced, the European Union is able to continue to subsidize hundreds, even thousands of times the quantity of dairy products that the U.S. is allowed to subsidize. An excellent example is the "Other" dairy product category – products like ice cream – where the EU will be able to subsidize a billion pounds of product while the U.S. is limited to 70,000 pounds.

Free trade appears to us to be a one way street running towards the United States. Increases in dairy product sales from the U.S. to other countries seem limited to the one time sales that are made using the Dairy Export Incentive Program (DEIP).

The following data tables, excerpted from a 1999 study done by the Food and Agriculture Policy Research Institute (FAPRI), give us a glimpse of the world trade picture. The tables below show that under the current trade agreement, the United States will never be a significant player in the world marketplace even though it is one of the largest milk producing countries in the world.

Note: All data is in thousands of metric tons, 2,204.63 pounds per metric ton.

Nonfat Dry Milk Powder

	2000	2001	2002	2003	2004	2005
Argentina	23	27	29	30	31	32
Australia	200	207	216	225	233	242
Canada	25	22	20	18	17	17
European Union	194	194	194	188	185	182
India	8	10	11	11	10	10
New Zealand	225	237	248	257	266	275
Poland	94	91	94	99	102	106
Switzerland	2	2	2	2	2	2
Ukraine	3	4	5	6	6	6
United States	107	79	68	68	68	68
Total Net Exports	881	873	887	904	920	940

Butter

	2000	2001	2002	2003	2004	2005
Argentina	7	8	9	10	10	11
Australia	104	105	108	111	114	117
Canada	11	10	9	8	8	8
European Union	115	121	125	128	130	132
New Zealand	327	331	335	337	340	342
Ukraine	51	51	53	53	54	54
United States	-9	-5	-5	-3	0	0
Total Net Exports	606	621	635	646	659	669

Cheese

Net Exporters	2000	2001	2002	2003	2004	2005
Australia	130	137	140	144	149	154
European Union	304	304	305	307	310	311
New Zealand	237	244	252	260	270	280
Total Net Exports	746	765	781	805	830	852
Net Importers						
Japan	196	204	214	225	238	251
Russia	243	259	268	276	285	288
United States	117	117	117	117	118	118
Total Net Imports	746	765	781	805	830	852

These tables show what a small share of the world market for dairy products the U.S. has. The export cheese market is estimated to be 1.6 billion pounds. Net imports of cheese into the U.S. account for 16 percent of the world market. The U.S. net exports of butter are zero. Only in nonfat dry milk powder and whey products is the U.S. a net exporter. Thanks to the DEIP program, the U.S. has about 12 percent of the world nonfat market.

I have the privilege of serving on USDA's Animal Agriculture Trade Advisory Committee. Most of what we hear at the meetings is how our various trading partners are not living up to their trade commitments. That is why I have recommended to the Alliance Board of Directors that we work for a continuation of a support type program until world markets are truly free, but more importantly truly fair. That means the complete elimination of government sanctioned activities like export subsidies and state trading enterprises.

We would like to see significant limitations put on all dairy product imports from countries that employ these and other trade distorting activities. It is interesting that when you look at the data USDA generates for dairy products sales in the U.S. most years, the milk marketings from our dairy farmers and total sales of dairy products on a milk equivalent basis match up pretty well.

When imports of dairy products are added in, either inventory numbers or Commodity Credit Corporation purchases increase. If we had fair access to world markets, that situation would be less likely to exist.

Milk Pricing Systems

The implementation of federal order reform brings milk pricing in California and in the federal order system much closer together. While differences still exist, the basic concept is the same.

Like California, federal orders now use product-based pricing. The market value of cheese, butter, whey and nonfat powder are used to calculate a minimum value for the producer milk used to make those products. As a result, prices will track much more closely then previously. For example, for the seventeen months from September 1998 through December 1999, the average difference in the cheese milk price between California and the federal order reform system would have been just 3 cents per hundredweight of milk. The so-called California advantage is no more.

And, California is adjusting its system to the federal system. On January 31, 2000, a hearing was held in Sacramento to consider proposals to adjust how California prices fluid milk relative to the federal system. The Alliance is hopeful that our proposal will be adopted by the California Department of Food and Agriculture and implemented on April 1.

Of course, being from California, I can't close without telling you how to improve the new milk pricing system. When we look at the system adopted in federal order reform, we have a few misgivings.

One is the use of NASS numbers for all commodity values. The Alliance believes that the Chicago Mercantile Exchange provides a better measure of what all cheese is selling for since virtually all other types of cheese are priced off the CME cheddar block price. All butter is priced off the CME butter market as well. NASS reporting is strictly voluntary and sales are unaudited. Consolidation of dairy product processing has concentrated the production of cheddar cheese and butter in fewer and fewer manufacturers. Some people may argue that the CME is a thin market because a small percentage of all the cheddar cheese is sold there. I contend that many more parties have an opportunity to buy and sell cheese at the CME than those who just produce it. As a result, thin is a relative term. If NASS is to continue to be used, especially for cheese and butter, then USDA should have the authority to audit reporting plants and reporting by all plants should be mandatory.

The other issue is manufacturing allowance determination. USDA should have the authority to require the reporting of manufacturing costs and to audit plants to verify that these costs are accurate. In this way, producers and processors can be assured that the numbers used to set the make allowances are real numbers. The Alliances wishes USDA had decided to use regional make allowances and/or product values to calculate milk prices as we and others suggested. To do otherwise creates winners and losers.

Summary

Few government policies have served an industry and consumers as well as the dairy price support program. It ensures milk producers that they will have a market of last resort for a highly perishable product. This, in turn, assures consumers that they will have an abundant supply of fresh milk and dairy products at reasonable prices. It should be continued through the term of the 1996 Farm Bill and perhaps beyond.

The Alliance urges this committee to take an active role in the upcoming round of trade negotiations. You are urged to ensure that agriculture's interests are not subjugated to the trade interests of other industries or other purposes. The ability to produce food is a form of security that no country can or should risk. That is why this committee as well as the House Committee on Agriculture must assure the constituents they represent that trade will be fair, not just free.

Thank you for this opportunity. I will be happy to answer any questions you may have.

Respectfully submitted,
Alliance of Western Milk Producers

Jim Tillison

Jim Tillison
CEO

Written Statement of Larry J. Jensen
Before the Senate Committee on
Agriculture, Nutrition and Forestry

February 9, 2000

Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today.

I am Larry Jensen, Senior Vice President of Supply, Distribution and Business Development for Leprino Foods. I also serve as Secretary and Treasurer of the International Dairy Foods Association and Chairman of the National Cheese Institute, one of the constituent organizations of the International Dairy Foods Association.

Background: Leprino Foods Company
Leprino Foods is a family-owned company that has grown from making small batches of ricotta and mozzarella cheese for delivery to local Denver grocery stores in 1950 to the world's largest producer of mozzarella cheese. Mozzarella represents one-third of the natural cheese produced in the United States. We operate eight manufacturing facilities that receive milk regulated by the Federal Milk Marketing Order (FMMO) system. These plants are located in New York, Michigan, Nebraska, Colorado, and New Mexico. Additionally, we operate two manufacturing facilities that are regulated under the California state order.

Leprino markets mozzarella cheese domestically and internationally to major pizza chains, independent pizza restaurants, as well as to many of the nation's leading food companies. We produce a full range of whey and lactose products that are marketed to customers worldwide, and enjoy a particularly strong presence with those products in the Japanese market.

We are profoundly interested in the dairy policy issues discussed at these hearings. Federal dairy policy is complex and has far-reaching impacts on the structure and competitiveness of the U.S. dairy industry. While we do not advocate total deregulation, we believe it is critical that federal dairy policy evolve to be less intrusive on dairy markets and the industry. Federal dairy policy should allow natural regional and scale efficiencies to develop and manifest themselves in the marketplace. This means allowing milk production to flourish in highly efficient regions and facilitating a conversion to more efficient methods in traditional production regions. It is critical that greater efficiencies develop throughout the industry in the years to come so that trade barriers are not needed to protect our domestic markets.

Current Context for Federal Dairy Policy
Federal dairy policy operates today in a different environment from a decade ago in two significant ways: (1) we need to be increasingly cognizant of global competitiveness in the context of our WTO commitments, and (2) we need to be increasingly wary of inducing surpluses in the context of Federal budgetary limitations and limitations on subsidized exports under the WTO.

The implementation of the WTO in 1995 represents both an opportunity and a threat. As European trade-distorting subsidies are rolled back and as market access barriers in the European Union and other competing markets are reduced and eliminated, the world price for dairy products will rise, providing significant new market opportunities for U.S. dairy products. Although significant trade-distorting export subsidies exist today, we expect further rounds of negotiations to eventually lead to the elimination of subsidies and the roll-back of dairy trade barriers. With the elimination of export subsidies, U.S.-produced dairy products will become competitive throughout much of the world.

However, the increased market access under the WTO also represents the threat of lost domestic market share if U.S. policies do not encourage the continued evolution of efficiencies in our dairy industry. If we are not price competitive, our domestic markets will be usurped by foreign dairy products. Although current tariff rates are sufficiently high to provide substantial protection from lower cost producers elsewhere in the world, the cheese industry suffered through an increase in imports during recent periods of extraordinarily high cheese and milk prices. Last summer, when wholesale cheese prices reached a record high of $1.9725 per pound at the Chicago Mercantile Exchange, imports of cheese increased, displacing cheddar in the production of processed cheese and contributing to a very rapid decline in cheese prices to the $1.11 level at the CME today.

The reduction of subsidized exports under the WTO and the extension of the price support program also begs for a regulated price policy that neither encourages unneeded milk production nor encourages investments in facilities that produce products highly dependent on government purchases or export subsidies, such as nonfat dry milk.

In this context, it is ever more critical that our policies encourage investment in highly efficient manufacturing facilities located in regions of the country where milk is most economically produced. We need to direct our investments to products with strong and vibrant commercial markets. By doing so, we will ultimately reduce our vulnerability to the relaxation of domestic tariffs.

Federal Milk Marketing Orders

One of the most complex aspects of federal dairy policy is the Federal Milk Marketing Order (FMMO) system. Through this system, the United States Department of Agriculture (USDA) sets the minimum price that must be paid for approximately 70% of the U.S. milk supply. The FMMO system is a potent tool in that the price discrimination used to establish a different price for milk depending on end use can, and does, distort production and investment decisions across product categories. Additionally, the level at which the minimum price is set impacts the industry structure; for example, the establishment of the minimum regulated price above market-clearing levels discourages private investment in the facilities required to process the milk while, at the same time, encouraging farm level milk production.

The Federal manufacturing milk price policy in place prior to the USDA reforms stifled the U.S. dairy industry's transition toward global competitiveness. This policy established a minimum price for milk used for cheese making (Class III) based on the competitive value of milk for manufacturing in Minnesota and Wisconsin (the M-W and, more recently, the BFP). Forty years ago when the M-W was adopted, the nation's surplus supply of milk largely existed in Minnesota and Wisconsin and little manufacturing occurred outside the upper Midwest. Accordingly, at that time the M-W price reflected the market-clearing value of milk for the nation's primary reserve supply. Over the last forty years, the structure of the industry changed significantly with the tremendous growth in milk available for manufacturing in the western states. Additionally, the supply / demand balance in the upper Midwest has tightened so that demand exceeds supply. As a result, manufacturing milk prices in this region are among the highest in the U.S. as manufacturers must pay higher prices to secure milk and keep their plants operating at optimum levels. Consequently, the minimum regulated price for manufacturing milk in much of the United States was being established in a region where surpluses no longer exist and prices were quite high.

By setting the minimum Class III price at its "midwest" value, the former pricing system overvalued milk in western states excluding California, which maintains its own milk pricing policies. USDA surveys and industry experience clearly indicate that the value of cheese is lowest in the west, where production outstrips consumer demand, and the highest in the east, where consumer demand outstrips production. Since the finished product value is lower in the west, the inherent value of milk is lower in the west. The overvaluation of milk in the west through the former Class III price, discouraged proprietary investment in processing facilities in the region. Cooperatives, which are not subject to FMMO minimum pricing provisions, have been forced to clear the market in parts of the west by initially transporting the raw milk long distances to find manufacturing capacity and eventually by building condensing plants or other facilities to produce products in a more transportable or storable form. Many of these products, such as nonfat dry milk, do not enjoy strong commercial demand. In some areas, such as Idaho, where a low Class I utilization minimizes the benefit of participating in the Federal Order pool, proprietary investment has thrived by by-passing the FMMO regulations altogether and paying for milk based on local competition.

The former Class III pricing mechanism effectively discouraged the development of processing facilities in the region of the country where milk can be most economically produced, thus hampering the U.S. dairy industry's drive toward greater global competitiveness.

Recognizing these and other shortcomings, Congress asked USDA to reform the complex FMMO regulations in the Federal Agricultural Improvement and Reform (FAIR) Act of 1996. After nearly two years of data collection and study, as well as extensive input from industry and academia, USDA announced a package of reforms that were to take place last year. After much discussion and several legislative changes, the modified reforms were implemented in January of this year. I would like to focus the balance of my comments on USDA's reforms as they relate to milk used for manufactured products, such as cheese.

USDA made several significant strides forward in their first effort to reform milk price policy in the context of the new global market realities. These advances included replacing the antiquated

Class III milk pricing system (BFP) with a broader price measure tied directly to the national average finished product value of cheese and its by-product, whey. Additionally, for the first time all milk in major manufacturing markets will be priced based on the components upon which its cheese making value is derived -- protein, fat and other solids. The past practice of placing most of the regulated value on total volume incented producers to employ feeding practices that increased the fluid carrier in milk, while providing no incentive to increase protein which contributes to enhanced cheese yield. The former system discouraged efficient milk production for cheese making.

Unfortunately, the Federal Milk Marketing Order reforms became highly controversial last year and led to several provisions in the Omnibus Budget Bill that overturned significant portions of the reforms. While the final dairy provisions did not directly overturn USDA's Class III price formula there was much discussion regarding one aspect of the formula used to calculate the Class III price, the "make allowance." The make allowance is one of many factors used in the Class III price formula, all of which combine to establish a minimum milk price based on the raw milk value of cheese and whey. In its simplest form, the new Class III price is calculated based on a national average cheese price (based on USDA surveys of the price received by manufacturers) that is reduced by an estimated cost of converting raw milk into cheese (the "make allowance"). The resulting net cheese price is multiplied by the volume of cheese that can be made from a volume of milk (the "yield factor"). The result of a similar calculation on the sweet whey value of milk is also part of the new Class III price. It is important to understand that the make allowance is not a payment to cheese makers and its use in the Class III formula in no way guarantees cheese maker profitability. The only function of the make allowance is to translate a finished product value of milk into a raw milk equivalent value for the purpose of setting a minimum price that proprietary processors must pay under FMMOs.

We believe that the debate in Congress last year over the "make allowance" in the Class III price formula was based largely on erroneous preliminary estimates of the price impact of the new formula. Lacking historic data upon which to calculate the impact of the new price formula, USDA estimated a reduction in Class III prices of $0.47 per hundred pounds of milk under their reform. However, current USDA data shows for the sixteen months from September 1998 through December 1999 (the only period during which data was collected to calculate both the old BFP and the new Class III price), the new minimum prices would have averaged the same as the old BFP (at 3.5% fat standardized levels), and actually would have resulted in a slightly higher milk price at the average component composition of milk produced in the United States. In fact, although the average cheddar price dropped in January, the Class III price increased due to the reform implementation. We believe that Congress did the right thing in allowing the new Class III pricing formula to go into effect rather than hastily adopting a new formula that would have increased the price in response to the erroneous preliminary price impact estimates. Hearings at USDA this spring will allow for additional data to be collected to support a final decision on the Class III price formula.

The Future of Dairy Policy

Although we are supportive of USDA's reforms, Congressional efforts last year muted some of the progress that was made toward reducing the market intrusiveness of the regulated system. Moreover, while we are appreciative that Congress did not legislate over USDA's Class III decision, we are concerned with what we perceive to have been strong sympathy for increasing the market intrusiveness of the milk pricing system.

It is important to remember that FMMO Class prices are minimums, not maximums, to be paid by processors. In fact, premiums above the minimum regulated price are commonplace. Those premiums are critical to transmitting market signals, such as the need to produce higher quality or higher protein milk, to producers. If the minimum regulated price is set at a level below what the market would otherwise dictate, premiums will adjust to reflect local supply and demand conditions. However, few options are available to proprietary processors if minimum regulated prices are set at a level above what the market would otherwise dictate. FMMO Class prices must be set at market clearing levels in all regions of the country so that manufacturing capacity will develop in the most efficient milk producing regions based on market factors, rather than government regulation. As a result, the U.S. will be much better positioned to seize the increasing opportunities of global competition.

Today, we have in place a Federal Milk Marketing Order system that is complex and still intrusive on the market. The dairy support price program was extended for this year, and USDA just last week announced their support for extending it through 2002. One of the last decisions of Congress last year was to extend the Northeast Interstate Dairy Compact. Compacts provide a protected market for a small group of farmers to the detriment of other farmers and consumers. All of these changes combine to put the dairy industry farther behind our competition. Whether from other domestic food product choices, or from dairy industry players in other countries, our federal dairy policy continues to hamper our dairy industry's ability to grow and prosper.

Mr. Chairman, members of the Committee, the U.S. cheese industry is now the largest user of farm milk and is experiencing strong growth in market demand year after year. We have great opportunity to grow markets domestically and earn a greater share of international markets if we keep our focus on the market and make sure our policies help pave the way, rather than impede our progress. As you debate Federal dairy policy, we urge you to adopt those policies that will allow the industry to flourish in the long-term.

Thank you for this opportunity to appear before you today.

Family Dairies USA

Statement of
Dennis Meyer, Producer
Bernard, Iowa
and
Member, Board of Directors
Family Dairies USA

Before the
U.S. Senate Committee on
Agriculture, Nutrition, and Forestry
Public Hearing
February 9, 2000

Good day and thank you, Chairman Lugar and members of the Committee, for this opportunity to share our members' concerns on dairy policy. I am Dennis Meyer, a board member of Family Dairies USA. I am a dairy farmer from Dubuque County, Iowa, in America's traditional "Dairy Heartland." My wife Darlene and I milk 92 cows and farm 384 acres of land.

Family Dairies USA is a grassroots organization representing over 6,000 small and medium-sized dairy farm families in nine Midwest states. The annual survey of cooperatives published in the October 10, 1999 issue of *Hoard's Dairyman* magazine ranks Family Dairies USA as one of the nation's largest dairy co-ops in terms of membership. We are working closely with other groups to reform harmful federal dairy policies that discriminate against our members.

The original goal of this cooperative has been a single, national milk marketing order that treats all producers equitably. During the recent federal order reform process, we sought basic reforms that bring needed equity and simplicity and move us toward our original goal. These reforms included much flatter Class I differentials, broad order consolidation that raises Midwest Class I utilization much closer to the national average, a competitive Grade A-B pricing system recognizing the full competitive value of farm milk, and the inclusion of California in the federal order system. Though Secretary Glickman's reform package made only a modest step toward our overall reform goals, we nevertheless believed it was an important step toward a better system. Therefore, we are deeply disappointed that Congress interfered in the reform process by blocking even these modest reforms in Secretary Glickman's final rule. Now that Congress has derailed these modest reforms, we urge Senate and House leaders to work with us to bring needed equity and simplicity through other means.

We are strongly opposed to regional dairy compacts. Compacts are contrary to our goal of a uniform national dairy policy that treats all dairy producers equitably regardless of where they live or where their milk is marketed. These unfair milk-pricing cartels erect new trade barriers to the movement of raw milk among regions of the country. Like the Eau Claire-based Class I differentials, compacts legalize the principle that it's okay to maintain pricing rules that discriminate against many producers in some regions.

We shouldn't have to discuss compacts. The Northeast Interstate Dairy Compact was not part of the 1996 Farm Bill debate until it was inserted at the last minute in conference. Since July 1997, the Northeast Compact has fixed the regional price of fluid milk in the New England States. Since the compact was to be a transitional step between outdated federal milk regulation and federal milk order reform mandated by the 1996 Farm Bill, Congress scheduled it to sunset in April 1999.

Unfortunately, the opponents of dairy reform inserted provisions in the fiscal year 1999 omnibus appropriations bill that delayed the sunset of the Northeast Compact until October 1, 1999 as part of a broader effort to delay and obstruct the reform process. Allowing the extension of the Northeast Compact amounted to major backsliding from the 1996 Farm Bill which was intended to move the dairy industry toward greater market orientation in milk pricing. And again at the end of last year, through the fiscal year 2000 omnibus appropriations bill, we saw the Northeast Compact renewed for two more years, through yet another backroom political deal.

The extension of the Northeast Compact has emboldened other states to pursue these regional dairy compacts, in search of a quick, easy answer to the complicated problems of dairy policy. Many states have enacted or are considering legislation allowing them to join the Northeast Compact or form a Southern Dairy Compact. If Congress were to authorize expansion of the Northeast Compact or a Southern Compact, what was to be a temporary crutch in the New England States could engulf over half the states and seriously endanger the Federal Order System.

Milk price volatility and farm level prices are the core issues in the debate on dairy compacts. From late 1998 through 1999 raw milk prices went from record highs to record lows. With milk price supports scheduled to be phased out at the end of this year, price volatility is a major concern for our industry. Small to negative profit margins combined with extreme volatility is financially disastrous for dairy farmers. Farmers, processors and consumers will all benefit from a greater degree of price stability in dairy markets. Dairy compacts, however, are not the solution to the price stability problem. Surplus milk production in the Northeast Compact region depresses manufacturing milk prices for producers in our region, further adding to our price volatility.

Compacts are not slowing the decline of small dairy farms. Compacts pay a premium on milk production without regard to farm size, so large operations receive more benefit than small farms. Ironically, statistics from the New England Order indicate that the rate of decline in small dairy farm numbers has actually increased since the inception of the Northeast Dairy Compact, while the number of large farms has grown at an accelerated rate. The Northeast Compact has failed in its primary mission of preserving small dairy farms in the New England region.

Farmers outside the compact region would see their milk prices lowered to benefit dairy farmers within the compact area. About 34 percent of producers in the nation reside in the states where compacts either exist or are under active consideration. By artificially propping up the price of milk for 34 percent of the producers in the nation, compacts directly depress the price for the other 66 percent of the nation's producers.

The Northeast Interstate Dairy Compact has caused surplus milk production in the member states that has depressed manufacturing milk prices for producers outside the compact area. Artificially high prices both stimulate production of raw milk and suppress demand for bottled milk. The resulting surplus must be manufactured into products such as cheese and butter. This is a serious problem for the Midwest where up to 85% of our milk is made into manufactured dairy products whose prices have been reduced because of surpluses created by the Northeast Compact.

A 1999 University of Missouri study shows that a majority of producers in the nation would be harmed by the combined effects of regional compacts in the Northeast, Mid-Atlantic and Southeastern states. Producers in every region outside of the Northeast, Mid-Atlantic and Southeast stand to lose between 17 and 21 cents per hundredweight of milk, according to the study.

While the study shows that producers in the compact region benefit from compacts, those benefits also would come at the direct expense of fluid milk consumers in the compact region. According to the Consumer Federation of America, the Northeast Compact has already cost New England consumers about $88 million in higher milk prices. The International Dairy Foods Association estimates that the cost will rise to $2 billion annually for 60 percent of the nation's consumers if compacts are expanded as proposed.

Nutrition program costs also rise under dairy compacts. The Consumer Federation of America estimates that Food Stamp Program costs have increased by $9 million in the New England states since the Northeast Compact was started.

If allowed to continue, compacts will carve the country into milk trading blocs. This harmful balkanization of the milk industry will further distort milk prices and supplies. Open interstate commerce has been one of the major hallmarks of our national economy since the birth on our nation. Dairy compacts are an unjustifiable exception to this rule, pitting farmers in compact states against those who are not.

As Secretary Glickman noted in his February 10, 1999 testimony before the House Agriculture Appropriations Subcommittee, compacts fly in the face of a national dairy policy by erecting trade barriers between regions.

Congress should not approve agricultural policies that so clearly provide benefits to the producers of one region, at the direct expense of the consumers of that region and producers elsewhere. Instead, there should be an effort to create a more rational and uniform national dairy policy. The Secretary of Agriculture should have the flexibility and authority to maintain a sound and cohesive national milk pricing policy, without the regional fragmentation caused by compacts.

At a time when so many Members of Congress are raising concerns about trade barriers erected by other nations against American products, it would be ironic to allow similar trade barriers to be erected within our borders, hindering commerce between regions of the United States. But compacts do exactly that. By fixing milk prices at artificially high levels, the compact proponents understand that their markets become vulnerable to market forces at work elsewhere in the nation. So in order to prevent milk from other regions from entering those compact markets at lower prices, a tariff-like mechanism is established to assure that all milk entering the compact area is priced at the level fixed by the price-fixing commission in the region. This essentially insulates that region from competition or trade from other regions.

Congress would be making a mistake to further expand or extend the Northeast Compact or authorize any new dairy compacts. Compacts are inconsistent with the broader federal milk marketing order reform process laid out in the 1996 Farm Bill. To retreat to compacts against the background of Congress's work reflected in the 1996 Farm Bill would be a huge step backwards and a costly mistake.

If we allow regionally biased policies such as compacts and high Class I differentials to control dairy policy, we will never move beyond the divisions that have plagued our industry. Let's work together to find national solutions to our national concerns.

Thank you for this opportunity to present our views.

Statement of the American Farm Bureau Federation

TO THE
SENATE AGRICULTURE, NUTRITION AND FORESTRY COMMITTEE
REGARDING
THE DAIRY INDUSTRY AND MILK PRICING

Presented by
Clark W. Hinsdale, III
President
Vermont Farm Bureau, Inc.

February 9, 2000

600 MARYLAND AVENUE SW • SUITE 800 • WASHINGTON, DC 20024 • (202) 484-3600 • FAX (202) 484-3604
225 TOUHY AVENUE • PARK RIDGE, IL 60068 • (847) 685-8600 • FAX (847) 685-8896
Internet: http://www.fb.com/

As the national voice of agriculture, AFBF's mission is to work cooperatively with the member state Farm Bureaus to promote the image, political influence, quality of life and profitability of the nation's farm and ranch families.

FARM BUREAU represents more than 4,800,000 member families in 50 states and Puerto Rico with organizations in approximately 2,800 counties.

FARM BUREAU is an independent, non-governmental, voluntary organization of families united for the purpose of analyzing their problems and formulating action to achieve educational improvement, economic opportunity and social advancement and, thereby, to promote the national well-being.

FARM BUREAU is local, county, state, national and international in its scope and influence and works with both major political parties to achieve the policy objectives outlined by its members.

FARM BUREAU is people in action. Its activities are based on policies decided by voting delegates at the county, state and national levels. The American Farm Bureau Federation policies are decided each year by voting delegates at an annual meeting in January.

STATEMENT OF
THE AMERICAN FARM BUREAU FEDERATION
TO THE
SENATE AGRICULTURE, NUTRITION AND FORESTRY COMMITTEE
REGARDING
THE DAIRY INDUSTRY AND MILK PRICING

Presented by
Clark W. Hinsdale, III
President
Vermont Farm Bureau, Inc.

February 9, 2000

Thank you , Mr. Chairman. My name is Clark Hinsdale, III, president of Vermont Farm Bureau. I am a producer from Vermont and have been very active on federal dairy issues. Farm Bureau's membership includes the majority of the nations dairy farmers. I am presenting these comments today on behalf of the American Farm Bureau Federation.

As you are aware, Farm Bureau was active both in the milk order reform process that has recently been implemented and also in the dairy debates that took place in Congress last year. I would like to thank the members of Congress for actions that you took last year relative to dairy. Extension of the dairy price support program for one year, the implementation of the Option 1A differentials for Class I milk in the new orders, extension of the Northeast Compact and providing additional Market Loss Payments to producers have all helped to provide some additional stability for dairy producer income across the nation.

One of the questions that you have asked is: "What is the status of the dairy industry in America?" As with all of agriculture, it is an industry in transition. Although prices paid to dairy farmers are extremely low now, the past two years have been good years for most producers as milk prices have been higher than in the past and, due to price problems in the grain sector, feed prices have been generally low. This combination of factors was likely a primary factor in the smaller than normal loss of dairy farms that occurred between 1998 and 1999. We found in the annual Farm Bureau survey of the number of dairy farms that we lost 4.2 percent of the dairy farms during the year. This compares with 8 percent the previous year.

I mentioned that the industry is in transition. A few numbers will help put this into perspective. When Farm Bureau began collecting data on dairy farm numbers in 1992, we had a total of 131,535 farms selling milk in the country. This past July we had dropped to 87,669. This means that we lost one-third of our dairy farms in that seven- year period. However; even within the dairy industry this herd loss wasn't uniform. In looking at Grade A farms we found that 29 percent had left the industry, while in the manufacturing grade farms there was a loss of 52 percent of the operations. Herds are also getting larger. Based on USDA cow numbers and Farm Bureau herd numbers we have moved from an average herd size of 73 cows in 1992 to 104 this past year. Based on analysis provided by the milk market administrator's office in Tulsa, we see another indication of the consolidation that is taking place in the countryside. Their data shows that 257 counties now produce about 75 percent of the milk in the country and that the top 81 counties produce 50 percent of the milk. While these changes have significant impacts on the families who are or were operating the dairy farms, there is little noticeable impact on consumers as total milk production has increased by about 10 billion pounds during this same time period.

The changes on the producer side of the industry are significant, but we still have not seen the vertical integration in dairy that is taking place in other segments of the dairy industry or in other sectors of animal agriculture. During the past two or three years there has been significant consolidation in both the processing and the retail sectors, meaning there are fewer buyers for our products. In response, cooperatives have also expanded and in some cases now have members from coast to coast.

While the large majority of dairy producers are members of cooperatives, they are still independent operators. If we compare the dairy industry with other sectors of animal agriculture, two differences are apparent. One is the presence and widespread use of cooperatives by producers and the other is the federal milk marketing order system. Both help to equalize market power between buyers and sellers of milk. For this reason we favor maintaining the federal order system, and maintaining its integrity. We supported reform of the federal milk marketing orders and were actively involved in the process. As I noted previously, we appreciated the action by Congress to require the use of Option 1A differentials for Class I milk and also that USDA held hearings to review the price movers for Class III and IV milk. These actions, coupled with the changes included in the final rule by USDA, provide a very workable system for the future.

Last year we supported the extension of the dairy price support program through the end of the current year. We recognized at that time that a longer extension would be desirable, but we chose to move forward to address the immediate need at that time. We now encourage you to provide a further extension to make the program consistent with other commodity programs. While prices have generally been above the support level, the dairy price support program does serve as an important safety net for producers and is likely to be needed for the next few years. December's basic formula price (BFP) of $9.63 per hundred pounds of milk was the lowest BFP ever, and the lowest Class III price mover since August 1978. This is actually 17 cents below the current support price, which is based on product prices of $0.65 cents per pound for butter, $1.01 per pound for powder and $1.10 for cheddar cheese. If we were to eliminate the price support program, then the world price becomes the only floor for our prices. To provide you with a frame of reference, for the impact this could have, world prices currently stand at approximately $0.57 per pound for butter, $0.68 per pound for powder and $0.79 for cheese. If farm gate prices to U.S. producers were to reflect these prices, it would devastate the industry and the rural economy. Again we strongly encourage you to extend the dairy price support program to make it consistent with other commodity programs.

There are two other actions that we encourage you to take to strengthen the safety net for dairy producers, one is full funding of the Dairy Export Incentive Program (DEIP) and the other is to support regional dairy compacts. The DEIP is an important tool for the dairy industry to combat the export subsidies of the European Union. The amount of product that we are able to move under the program has been reduced, to reflect our commitments to the GATT agreement, but it is still an effective tool. It helps our industry open international markets and provides more stability to domestic prices by moving more of our milk powder into export channels.

The Northeast Dairy Compact has proven to be an effective tool for producers in that area of the country to gain more income from the market. It is estimated that the compact has returned over $40 million to producers from the market in that region. Delegates to this year's annual meeting of the American Farm Bureau Federation reaffirmed past policy, stating: "We support state and regional initiatives or compacts which are consistent with our overall goals of federal market order reform and a market-oriented national dairy program." They also added new language in another section of our dairy policy, stating: "We support modifications in the Federal Milk Marketing Order that will enhance the price of milk received by producers, including but not limited to:
(1) Option 1-A price differentials for Class I milk,
(2) Adjusting USDA formula for make allowances on Class III milk; and
(3) Regional dairy compacts."

Twenty-five states have passed legislation authorizing regional compacts. We support legislation that would extend the current Northeast Dairy Compact to include Maryland, New Jersey, New York, Delaware and Pennsylvania. Farm Bureau supports the authorization of a Southeast Dairy Compact which would include all of the Southern states plus Missouri, Oklahoma, Kansas and Texas. We encourage you to continue to allow producers and the industry to work together through efforts such as the Northeast and Southeast Dairy Compacts to stabilize producer income.

We appreciate the opportunity to provide these comments to you about the current status of the dairy industry, the importance of the dairy program and the milk order system. We look forward to working with you in the coming year as we seek to address challenges facing the industry.

Testimony Before the Senate Committee on Agriculture, Nutrition and Forestry

John Neal Scarlett

New Market, Tennessee

South East Dairy Farmers Association

February 9, 2000

First, I would like to thank the members of the Senate Agriculture Committee for holding these hearings and for giving a family dairy farmer from East Tennessee the chance to be here. My family and I milk just over 200 cows on a family farm started by my grandfather in 1930. We market our milk as independent producers through Piedmont Milk Sales, a marketing organization for about 260 producers. Piedmont is a member organization of the South East Dairy Farmers Association.

I would like to begin my testimony by thanking the members of the Senate who made sure that a flawed attempt to change the federal milk regulatory system last year was reformed. I'm all for making the system work better, and that's what the Congress did last fall. There are a couple more changes to make, but those will work their way through the regulatory process at USDA this year.

My purpose this morning is to let you know how important the Federal Milk Marketing Order Program is to the dairy industry in my part of the country. The main purpose of the Federal Order Program is to provide for an orderly flow of fresh fluid milk for the consumer. In the Southeast, for most months of the year, that is a very serious challenge.

As most of you are aware, the Southeastern United States has a rapidly growing population. That rapid growth makes it even more difficult to keep the market adequately supplied with milk for drinking. But the transportation cost of moving milk from areas of the country where there is more than enough for drinking makes it more cost-efficient for consumers to maintain a local supply of milk.

For instance, hauling milk from northeastern Wisconsin to east Tennessee adds $3.39 to the price of a hundredweight of milk. That's 29 cents per gallon. From upstate New York it adds $3.16 or 27 cents a gallon. Now those figures aren't somebody's estimates, they're actually what my milk company has paid to have milk hauled when we needed some to fill an order. Two charts attached to my written testimony demonstrate hauling charges to several southeastern locations.

This is nothing against dairy farmers in Wisconsin or New York. I have friends who are dairy farmers in Wisconsin and New York and I hope we stay friends. But you cannot pay those farmers the going rate for milk, compensate the plant that gave up the milk, haul it to east Tennessee and put that milk on the store shelf for less money than you can put my milk on the same store shelf. Federal Order minimum pricing, in the interest of farmers and consumers, provides a financial incentive for keeping at least some milk production local.

The local economic impact of dairy farming just cannot be underestimated. In my county alone the $6 million in annual milk checks, using the multiplier effect of six dollars for every dollar of agriculture sales means an additional $36 million in local spending. And in Tennessee, tax revenues generated from that spending are how we build our schools, educate our children and provide the other essential county services.

A local supply of milk is also a much more dependable supply than milk from far away. Those of you here in Washington, DC will remember the travel problems caused by the snowstorm a couple weeks ago. If it was that hard for you to get to work for several days in a row, imagine what it is like trying to get milk trucks moved between farms and plants and delivery trucks between plants and stores within the Southeast during that time.

Bottling plants in the area were begging for milk two weeks ago to meet consumer needs. Milk was readily available in other parts of the country but weather conditions prevented it from reaching the market - store shelves were empty in some areas, sales opportunities were lost and some consumers were without milk. Now imagine what it would be like if all the milk needed in the region had to come from far away.

It's consumers going without milk and the lost sales opportunities for farmers that the Federal Order Program helps us avoid as much as possible. Providing financial incentives to help keep milk readily available for everybody every day and at a reasonable cost is exactly what the Federal Order Program helps us do. And that is good for farmers and consumers alike.

The Federal Order Program also provides other functions that are important to the entire dairy marketing chain. Processing plants and milk handlers are regularly audited to ensure that producers are paid the Class I price when the milk is sold as beverage milk, the Class II price when the milk is used to make yogurt or cream cheese, the Class III price for cheese manufacturing milk and the Class IV price for milk used to make butter and powder. Producers are also assured that they are paid for the components of their milk, such as protein and butterfat, and weights are checked so that producers are paid for what they ship and processors are paying only for what they are getting.

The Program, however, is only as good as the quality of the information it gathers. The need for accurate and credible auditing was pointed out last fall when a substantial amount of cheese inventory was missed one month. The resulting market signal was that more milk needed to be produced. Once that cheese was discovered in the warehouse, however, a milk price drop that was already coming was amplified severely.

An entirely understandable question after all this, of course is, "Does the market still get to work?" I can tell you from recent experience and in no uncertain terms that it does. In parts of 1998 and 1999, with weather-related production difficulties in just a couple areas of the country keeping milk supplies tight, we had record-high farm milk prices. Now, that situation is reversed and we have the lowest milk prices we've seen in 20 years. To put that into context for all the non-dairy farmers in the room, imagine trying to feed your family, pay your mortgage and educate your children if the paychecks you'll receive in 2000 are going to be 40% less than the paychecks you received in 1999.

Another reason we need the FMMO program is that as a dairy farmer, I am required to get my milk to a processing plant every day. That means I find myself in a situation where I don't get to hold on to my product to bargain for a better price. Let me put it another way. Most of us have been in a grocery store and seen a gallon of milk marked down to $1. It's usually marked down that low because the "Sell By" date is within a day or two. Well, that's the position I'm in as a farmer every day. If the milk produced on my farm today doesn't have a buyer today, I have a product that I can't sell at all. That is one of the most critical features of the Federal dairy program - keeping dairy farmers on an equal basis in a given market area prevents farmers from being pitted against one another to lower the price.

We've heard a lot of talk about deregulation for dairy pricing. First, let me say that the current Farm Bill did not authorize deregulation for dairy. It did not require changing Class I differentials and it most certainly did not authorize a program that would lower dairy farmer income. That is why it was so important for this Congress to intervene to repair the flaws in the Federal Milk Marketing Order Reform Final Rule last year. Without those changes, entire investments in farm facilities, processing and distribution facilities in some parts of the country would have been worthless.

Another aspect of milk price regulation that I haven't talked about yet is Dairy Compacts. On Compacts, I'd like to say that a Southern Dairy Compact would be a great help to the industry in keeping the fast-growing market in the Southeast adequately supplied with reasonably priced fresh milk. Compacts also allow everyone involved in the milk marketing chain to have a say in how milk is priced at the farm.

Also on the subject of Compacts, I'd like to make a call for a higher level of honesty in the debate about this issue. For instance, calling Compacts un-democratic simply isn't the truth. Over five thousand state legislators in 25 states have voted in favor of dairy compacts. And, last summer when an amendment with Dairy Compact language came before the Senate, it received 53 votes - a majority. Still, we do not have a Compact in the South. People in those states, even after their state legislators have spoken, are being denied the opportunity to have their input in keeping all the benefits of local dairy farms near their communities.

One other reason I wanted to be here today is to have the opportunity to remind this body and the American people that there is one group that is clearly not sharing in the general economic boom the country is experiencing right now. Virtually everywhere you look in agriculture right now, there are record-low commodity prices. As I said before, milk prices are at levels we haven't seen in 20 years. The Federal Milk Marketing Order Program helps provide at least a small degree of stability. But more is needed. I urge the United States Senate to continue looking for ways to keep farming economically vibrant. America's farmers and rural communities are depending on it. Thank you again for the opportunity to be here today.

Attachment A

Eau Claire, Wisconsin Mileage to Designated Cities

TO	One Way Miles	Hauling Rate	Hauling Cost	Load Size	Hauling Per CWT	Hauling Per Gallon
Knoxville, TN.	849	$2.00	$1,698	50,000	$3.3960	$0.2921
Nashville, TN.	728	$2.00	$1,456	50,000	$2.9120	$0.2504
Memphis, TN.	777	$2.00	$1,554	50,000	$3.1080	$0.2673
Asheville, NC	960	$2.00	$1,920	50,000	$3.8400	$0.3302
Charlotte, NC	1,077	$2.00	$2,154	50,000	$4.3080	$0.3705
Atlanta, GA	1,021	$2.00	$2,042	50,000	$4.0840	$0.3512

Attachment B

Syracuse, New York Mileage to Designated Cities

TO	One Way Miles	Hauling Rate	Hauling Cost	Load Size	Hauling Per CWT	Hauling Per Gallon
Knoxville, TN.	791	$2.00	$1,582	50,000	$3.1640	$0.2721
Nashville, TN.	864	$2.00	$1,728	50,000	$3.4560	$0.2972
Memphis, TN.	1,070	$2.00	$2,140	50,000	$4.2800	$0.3681
Ashevilla, NC	787	$2.00	$1,574	60,000	$3.1480	$0.2707
Charlotte, NC	726	$2.00	$1,452	50,000	$2.9040	$0.2497
Atlanta, Ga.	960	$2.00	$1,920	50,000	$3.8400	$0.3302

CITIZENS
AGAINST
GOVERNMENT
WASTE

Statement of
John E. Frydenlund, Director
Center for International Food and Agriculture Policy
Citizens Against Government Waste
Washington, D.C.

Committee on Agriculture, Nutrition and Forestry
United States Senate
February 9, 2000

Mr. Chairman and members of the committee, on behalf of Citizens Against Government Waste (CAGW), thank you for the opportunity to testify on the subject of whether there is a need for a federal dairy policy.

CAGW is a 600,000-member, nonprofit, nonpartisan organization, which grew out of President Reagan's Private Sector Survey on Cost Control, better known as the Grace Commission. The organization's mission is to work for the elimination of waste, mismanagement, and inefficiency in the federal government, with the goal of creating a government that manages its programs with the same eye to innovation, productivity, and economy that is dictated by the private sector.

The Center for International Food and Agriculture Policy institutionalized CAGW's long-standing goal of dismantling Depression-era agricultural price supports and regulations. In addition to a belief that Congress should build on the accomplishments of the 1996 Freedom to Farm Bill and achieve a truly free market for agriculture, the Center advances the philosophy that the best way to wean America's farmers off the federal dole and assure them a prosperous and secure future is to promote a more open global food economy by dismantling barriers to free trade.

CAGW applauds Chairman Lugar for holding this hearing, particularly for asking the right question: "Is there a need for a federal dairy policy?" It is appropriate to begin a discussion of dairy policy with such an examination, rather than the traditional assumption that there should be a dairy program, which then simply moves to a debate of what that program should be and how much money should be allocated on its behalf.

1301 Connecticut Ave., NW
Suite 400
Washington, DC 20036
202-467-5300

It is now well past sixty years since the federal government first determined that it needed to be involved in milk-pricing in order to "ensure a wholesome, stable supply of milk for the entire country." The result was the creation of a dairy price support program and the federal milk market order system. There *may* arguably have been some justification for federal subsidies and management of dairy production way back then before vast technological progress, modern production techniques to maximize output, efficiency and quality, and advancements in the nation's infrastructure made these policies obsolete.

Despite technological and scientific advancements, improved transportation, refrigeration and delivery systems, shifts in consumer demands and preferences, and an inevitable march toward a global marketplace, some in the dairy industry would like to remain frozen in time. In fact, during seven decades of modernization and change outside of Washington, the federal government's stranglehold on milk's pricing structure has remained constant.

As we enter this new millenium, it is still the policy of the federal government to artificially prop up dairy prices for certain dairy producers at the expense of taxpayers, consumers, dairy processors, and even a significant number of other, less politically-connected dairy farmers. Unfortunately, the industry has chosen time and again to cling to a system which stifles any future ability to compete.

Just as is the case in every other industry, technological innovations have allowed some dairy farmers to become more cost efficient. It should come as no surprise, then, that this country has experienced significant reductions in both the number of dairy farms and milk cows. The time has come for leaders to acknowledge that these trends represent progress rather than a cause for hand-wringing.

Alarmists often point to the fact that the number of dairy cows has dwindled from 24 million in 1940 to less than 9 million today. Likewise, total farms with dairy cows underwent a dramatic downward shift from 4.7 million in 1940 to less than 150,000 earlier this decade. Before one cites this data to write the industry's epitaph, however, additional statistics and analyses must also be taken into consideration. For instance, between 1940 and 1996, the amount of fluid milk produced per cow increased from 4,622 pounds to 16,498 pounds. As a result, the total amount of milk produced in the United States has increased from 109 million pounds in 1940 to a projected 162 million pounds this year, despite a sixty percent reduction in the number of dairy cows. Such evolutionary changes should be celebrated rather than interpreted as indicators of a dying industry.

Until relatively recently, the costs of federal meddling have been most blatantly demonstrated by the excesses of the dairy price support program, which laid out huge sums of federal taxpayer money to subsidize dairy farmers. In addition to this cost, each and every product which contains milk costs consumers more.

Not only do consumers pay for the program in the checkout line, they also bear the costs in other, more insidious ways. For example, the U.S. Department of Agriculture (USDA) uses tax dollars, at a cost inflated by the government involvement, to purchase subsidized milk and dairy products for the Women, Infants and Children(WIC) and school lunch programs, as well as for other government purchases, such as the military.

The federal dairy program is a tangled web of mind-numbing pricing schemes that have metastasized into a more layered, incomprehensible, intrusive labyrinth increasingly divorced from economic realities. Rather than allowing the marketplace to determine the price of milk, dairy prices are controlled by behind-the-scenes maneuvering in Washington, bureaucratic log-rolling, and regional political favoritism.

The federal government's two-fold entanglement in milk-pricing — through the dairy price support system and milk marketing orders — distorts the marketplace and protects a shrinking population of dairy farmers. In fact, the sheer complexity of the system, along with well-organized pressure from powerful, entrenched political forces, are the reasons reform has been successfully sabotaged over the years, regardless of which party controls Congress or the executive branch.

As with many other government programs gone haywire, intervention in the dairy industry was designed to be temporary. The preamble of the Agricultural Act of 1933, the first legislative foray into the industry, stated that the act was only meant "To relieve the existing national economic emergency by increasing agricultural purchasing power . . ." At the time, Congress reasoned that the dairy industry merited protection because of depression-induced instability in domestic markets and low milk prices. That emergency has been over for years, yet the legislation lives on.

Until recently, the dairy price support program had been the cornerstone of the federal government's involvement in the dairy industry. In the late 1970's and early 1980's, price supports were driven to unprecedented heights as a result of regional politics and election-year pay-offs to the farm lobby. Dairy producers, naturally, cranked up production to cash in on the windfall. In a vicious cycle, government purchases of the surpluses skyrocketed to absorb the additional production, with the government ultimately buying $17 billion worth of dairy products during the decade, almost $3 billion in 1982-1983 alone.

Inevitably, the mountains of surplus dairy products stretched federal storage space beyond capacity. To remedy this problem, the federal government decided to dump the cheese, giving much of it away for free. Of course, this move depressed cheese prices. In order to mitigate the disruptive impact its policies were having, the government took a number of actions aimed at bringing surplus production under control. It tried almost everything, except allowing the industry to operate under the principles of the free market.

First, the federal government tried a voluntary diversion program which paid farmers to reduce production. When that program failed, it turned to a "whole herd buyout" program under which farmers were paid to slaughter or export their herds and leave the dairy business for a period of five years, a program that delivered a devastating blow to the cattle industry.

These experiences led to less Congressional enthusiasm for raising dairy price support programs, so to some extent, the dairy price support program has been less relevant in recent years. As this has developed, the milk marketing orders have become the most important bulwark of federal involvement in milk pricing and the vehicle through which proponents of the status quo intend to keep a dominant federal hand in the dairy industry.

Rather than allowing commerce between dairy farmers and dairy manufacturers to flow freely, the milk marketing orders provide a raft of intricate regulations to govern the overall price to be paid for milk in different regions of the country. The orders undermine the most basic free market concept of negotiating contractual agreements between buyers and sellers.

Within the milk marketing orders' logic-free zone, the most illogical of all provisions is the "differential" pricing. These additional premiums are charged to the manufacturers of fluid milk based, in part, on how far the manufacturing plants are from Eau Claire, Wisconsin. At the time this scheme was devised, the rationale used to justify it was an alleged concern that conditions such as poor refrigeration and the nation's sluggish and unreliable transportation system would prevent localities far from milk-producing regions from receiving a fresh and wholesome product.

Today's milk production, preservation and transportation capacities obviate the need for differentials. The only reason that they continue to exist is because the less productive, less efficient dairy farmers, particularly from the higher-cost regions of the country, have become dependent upon the largess of the federal government, rather than their ability to compete, for much of their income.

Of course, this means that consumers in the higher differential regions pay higher prices for milk and dairy products. Perversely, the differential system also penalizes dairy farmers in the regions best-suited to dairy farming and rewards dairy farmers operating in high-cost inefficient areas far from Eau Claire. This makes about as much sense as the federal government requiring computers manufactured in Maine to be sold at higher prices than those manufactured in the Silicon Valley.

It is equally ludicrous that the federal government establishes a minimum price for milk or sets different prices for milk based upon what it is used for. The government does not establish minimum prices for cars, computers, steaks, apples, soft drinks, clothing. Elimination of this outdated system would result in milk marketing being more responsive to consumer demands and preferences. Freed from these senseless constraints, processors and manufacturers would pay greater attention to the marketplace and adjust their product ratios accordingly.

Elimination of minimum prices, milk classing and differentials would ultimately result in milk being produced where it can be done most efficiently and competitively and be manufactured into the products that are most in demand. Continued government involvement stands in the way of the industry's ability to adapt to changes in the economy, the environment, regional costs of production, or any other factors that might make one region of the country more or less competitive than another in milk production.

Furthermore, the federal milk marketing orders increase the price of milk to consumers by at least $1 billion annually. This estimate is based on the assumption that the federally-mandated minimum price reflects a market price, which is not the case. Nor does this estimate attempt to quantify savings that would result from the elimination of the other market-distorting features of the milk orders, such as the government's role in classifying and pricing milk based on its end usage. Therefore, the real cost to consumers of federal milk-pricing is likely closer to $2 billion annually. These costs amount to nothing more than a milk tax on consumers — and a very unfairly applied tax at that. Those who can least afford the added costs — low-income families with young children — are hit the hardest.

I believe everyone in this room is aware of the extensive and time-consuming effort, initiated in the 1996 farm bill, to provide modest reform of this system, which was totally scuttled by Congress last year. The road to reform will be difficult indeed when Congress will not even agree to allow forward-contracting of fluid milk. The extension of the Northeast Interstate Dairy Compact is also a serious setback for reform of this industry, although we can find some solace in the fact that Congress did not authorize the expansion of dairy compacts, at least for now.

Dairy compacts are nothing more than a legalization of cartels for the dairy industry. "Milk cartels," whether federally or state-sponsored, have no place in a free market. They would seem more appropriate to the old-style Soviet system, rather than a market-based system such as we have in the United States, except, of course, in the case of certain agricultural commodities.

Although CAGW has focused most of its attention on the adverse economic, consumer and taxpayer impacts of the compacts, the organization also believes that dairy compacts are an unconstitutional violation of the commerce clause. I cannot believe that anyone could read *The Federalist Papers* without concluding that the Founding Fathers intended that there be no restrictions on commerce within the United States. However, that is exactly what dairy compacts do.

In fact, in *Federalist No. 42*, Madison warned that if authorities were allowed to regulate trade between states, some sort of import levy "would be introduced by future contrivances." I would argue that the dairy compacts are exactly the sort of contrivance feared by Madison. Dairy compacts are clearly a restriction of commerce, and, in effect, they impose what amounts to a tariff between states. The Founding Fathers never intended the states to impose levies on imports such as those imposed by one nation on another's goods.

Throughout the history of this country, Congress has authorized the creation of interstate compacts. But, except for these dairy compacts, they have all been for the purpose of promoting commerce between states, rather than restricting commerce. I cannot find any precedent for a compact with the express purpose of preventing the sale of products from one state to another.

Interstate dairy compacts represent a threat to the long-term viability of the dairy industry. The dairy industry must become more competitive in order to benefit from modernization and technological progress and to capitalize on export markets. It must also become more responsive to customer demand. But, compacts are a slap in the face to the milk-drinking public.

There is no justification for another government-sanctioned layer of regulatory bureaucracy to regionally fix prices. Dairy compacts pit region against region, fracturing the country, and will prevent the industry from making the changes necessary to take advantage of an expanding global marketplace.

Compact advocates claim that these artificially high milk prices are necessary in certain regions in order to keep small dairy farmers in business and assure a stable milk supply. However, USDA's three years of research blows that argument out of the water and should finally put such nonsense to rest. One of the most important findings to come out of USDA's milk marketing order rule-making is a recognition that many of the existing Class I differentials are too high and that they can be reduced without jeopardizing an abundant supply of milk in all regions. Therefore, it is incongruous to turn around and raise Class I prices through more compacts.

Spreading dairy compacts from coast to coast will eventually put the dairy industry into the same chaos that developed in the late 1970's and early 1980's, when artificially high milk price supports led to excess milk production, declining sales of milk and government purchases of surplus production, costing taxpayers billions of dollars. Any artificial milk price increase beyond what the market demands will simultaneously drive down milk consumption and increase milk production and repeat the mistakes of that decade.

If compacts are allowed to swallow up a vast percentage of the country, the results will be devastating. The cost to consumers would dwarf the $55 million that has been imposed on New England's consumers. While the New England region produces about 3 percent of the nation's milk supply and accounts for only 5 percent of U.S. milk consumption, adding additional states to the Northeast Compact and creating a Southern Compact would bring nearly 40 percent of the nation's milk supply and almost 60 percent of the nation's consumers under the power of a milk-pricing cartel.

Dairy compacts impose an unfair "milk tax" on consumers. If compacts are allowed to spread, the consumer tax could amount to as much as $2 billion annually. It would also directly impact government spending by increasing the cost of the food stamp program, the school meals program and other child and elderly nutrition programs.

Rather than creating milk cartels that will add yet another layer of regulation, Congress should be considering how best, after over sixty years of government price manipulation, to get the government out of the milk business. It is time for Congress to recognize that dairy compacts violate the constitution, are a form of price-fixing, eliminate competition, provide for a more meddlesome bureaucracy, and will lead to the imposition of great costs to taxpayers in the future.

Congress must heed the lessons of the past as it makes decisions impacting not only the future of the dairy industry, but the entire country's consumers and taxpayers. Congress should oppose expanding the federal government's role in milk-pricing, as proposals to create additional compacts would do. Instead, Congress should return to the path begun in the 1996 Farm Bill to phase out the government's role in the dairy industry. The commitments made in the 1996 Farm Bill, including a phase out of the dairy price support program and a sunset to the Northeast Dairy Compact, should be kept. And the federal milk marketing order system should be eliminated.

In conclusion, CAGW believes that the system of federal government involvement in the U.S. dairy industry is completely irrelevant to modern-day economic realities and should be scrapped entirely. It is time to allow a completely free-market for the dairy industry, rather than extending subsidy programs, holding onto the outdated milk marketing order program and creating new milk cartel systems, such as the dairy compacts. In the long run, a dairy industry that is forced to become more competitive internationally will become more productive and profitable for everyone.

Cooperative Extension · University of Wisconsin-Extension
College of Agricultural and Life Sciences · University of Wisconsin-Madison

UW Center for Cooperatives
230 Taylor Hall, 427 Lorch Street
Madison, WI 53706-1503 USA
608-262-3981 FAX 608-262-3251
Telex 3797422: UofWISC MD

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Written Testimony
of
Will Hughes
UW Center for Cooperatives

Before the **United States Senate**

Committee on Agriculture, Nutrition, and Forestry

Federal Dairy Policy Issues

February 9, 2000

Testimony

Chairman Lugar, and other members of the Committee, thank you for the opportunity to appear before you today to speak about dairy policy issues.

I am Will Hughes, staff economist at the University of Wisconsin-Madison Center for Cooperatives. I am appearing here at the invitation of Senators Kohl and Feingold, I believe, because of my work over the past 10 years with the Midwest Dairy Coalition in its quest to seek federal milk marketing order reform. I thank the Senators their invitation and for their true wish to lead dairy policy in a direction that is good for all dairy farmers—both Wisconsin's and the nation's. Today I am speaking on my own behalf and not for the Midwest Dairy Coalition.

The past 10 years of dairy policy have been checkered primarily because we all are struggling with how to manage 60 plus year programs to address issues of the modern day. We have in the US a multi-faceted dairy industry with commercial farms with herd sizes ranging from 25-30 cows to 5000 cows, operators with high costs, others with low costs, areas primarily devoted to serving fluid milk markets and other areas primarily devoted to manufactured dairy products, and some who can make a profit on $11-12/cwt while others struggle with $14- 15/cwt. We have global dairy companies and their products that are aggressively seeking our markets. This makes it extremely difficult, and even contentious; to develop a set of national dairy policies that will serve all well and serve them equitably. Table 1 is attached to illustrate the diverse herd size and milk production distribution in the U.S.

There is no single policy tool that will address this wide variation in types of dairy farms. More likely it illustrates why broad-scope pricing regulations should be relaxed to let the dairy industry work on finding its own comparative advantages. Attempts to lift prices by government inevitably make matters worse by inducing more milk production and helping both those who need help and those who don't.

Amidst the destructive politics of regional issues that has largely gridlocked any real progress in dairy policy over the last decade, in my opinion, we have lost sight of what we want to accomplish. I suggest it is time to seriously re-examine the social contract between the government and dairy farmers, dairy processors, consumers and the public.

This re-examination should be done in the next farm bill. I suggest that the dairy industry will need a hammer over its head to accomplish what is needed. This hammer should be that Congress, primarily its leadership, would unequivocally de-regulate regional divisive dairy programs and perhaps all programs unless a national consensus can be reached on new dairy policy.

In my testimony today I would like to assess the current dairy policy situation and suggest a framework for getting us to and through the next Farm Bill.

You have heard from some in the dairy industry that USDA's federal milk marketing order (FMMO) reforms, directed in the previous Farm Bill and finally implemented January 1, 2000, then modified by Congress in the waning moments of the last session, have set policy right. Nearly all appreciate continuation of the dairy price support program and the $200M and $125M in direct payments that were dispersed in early 1999 and early 2000, respectively. You've heard from the Midwest that FMMO's are still unfair and from the Midwest, processors, and consumers that Interstate Dairy Compacts make matters worse. Others are clamoring for additional or extended Compacts and other drastic interventions to cushion dairy farmers from market conditions, which are at the moment dramatically low.

First I think you need to determine what you want dairy policy to accomplish and whether it is realistic to be able to do that.

Do you want to help dairy farmers achieve a targeted price objective, a targeted profit margin, or help keep a certain number or type of farmers in business? It is probably not realistic to achieve any of these objectives given the vast differences in the cost structures of today's dairy farmers, the fact that the majority of milk used in dairy products and not fluid milk, the fact that our system is free enterprise and unlikely to subject itself to mandatory production controls, and that our federal budgets are not limitless. Do you want to want to assist some farms more than others. For example, do you want to provide more support to fluid milk production than manufacturing because that is what we are doing today? Do you want policy to build for the future or protect the past?

I believe you will find that less not more direct price regulation will be the preferred course in the longer term. Too much regulation distorts markets, causing advantages for some and disadvantages to others, and finally removes important incentives to be innovative within the private sector—from the farm to the end-use buyer—in adopting productivity gaining measures and in building markets.

Today, too much is expected of current dairy programs. Our programs cannot deliver on the types of objectives expected. The result is frustration and further attempts to distort current programs to accomplish results for which they were not designed.

The Northeast Dairy Compact, which operates basically as a super FMMO for New England states, has been viewed as a means to keep farmers in business. That has not been the result as can be seen in the attached Table 2.

Attempts to use the FMMO as a price support program by proposals to super-inflate Class I prices or to floor Class I prices causes severe market distortions and exacerbate regional inequities. In effect, the result is to support fluid milk areas at levels much higher than manufacturing milk areas.

Second, you need to determine what tools can be used to support your objectives and they should be structured to work equitably for all of the nation's dairy farmers, not just for some.

Third, you need to deploy dairy policy tools so they work to balance the entire dairy economy not just parts. This would suggest that dairy programs be equitable to both fluid and manufacturing sectors as well as between regions.

Fourth you need to consider the interests of consumers and the public and how their interests are acknowledged. Today's dairy programs are not transparent with respect how these varied interests are considered and balanced.

It seems reasonable that a social contract between the dairy industry and government is warranted today and will be so in the future. This contract exists in different forms in different programs for different commodities. The track laid by the 1996 Farm Bill towards deregulation will be reexamined. Although I believe less regulation is desirable, I doubt we will ever have true deregulation in agriculture. I believe the public and consumers will continue to support a type of government contract with agriculture that serves to moderate downside markets, that preserves fair competition, and that enables a system of independent farming. I do believe the public would expect programs to benefit farmers uniformly across the nation.

What does this mean for dairy policy?

Markets and The Tendency to Over-Intervene

Dairy markets are powerful in responding to conditions of supply and demand. Any time with policy you attempt to inflate prices through regulation, or set high price supports, you induce supply, and set up a cycle of reduced milk prices. No one likes to manage farms or dairy plants or retail stores under the volatile milk prices as we have witnessed with the lowering of dairy price supports.

But the entire supply channel is learning how to manage the price risks inherent to this new era in the dairy economy. New contracting arrangements for forward pricing and more participation in traditional risk management tools will help manage or reduce some of the volatility. It is unlikely that government can do much more itself to remove current day price volatility. Government can help the dairy industry manage downside price risks. I suggest that be the future cornerstone of federal dairy policy.

Attempts to artificially raise prices will induce more production; it's an axiom. More milk will be generated from low cost areas and low cost producers than from higher costs ones. And, there are low cost producers in every area, even though they predominate now in the west. The unintentional result will be to aid low cost producers when they don't need help. Any attempt to prop up fluid milk prices, such as through higher FMMO Class I prices, or through Compacts, will increase production and reduce fluid milk sales, and provide the most help to those who need it least. This combination will send the extra milk to the manufacturing market and thereby depress prices in the manufacturing sector. That too is an axiom of economics.

Let's look at history. High price supports of the early late 70's and early 80's generated huge surpluses that kept prices stable, arguably at levels lower than farmers wanted, and at huge government costs. Congress' mandatory increases to FMMO Class I differentials in 1985 further added to surpluses. Temporary programs such as the whole herd buyout and the milk diversion program were tried, largely ineffectively, to address the well-intentioned, but surplus-causing government help.

The inevitable conclusion is that you cannot artificially raise milk prices without causing major distortions in markets and inequities among farmers unless you can either control supply directly at the farm level or dispose of excess dairy products.

The lesson is to be careful of too much regulation and the unintended consequences of adding to milk surpluses. Not an easy lesson to swallow when trying to help the farmer, but a necessary one.

FMMO Policy

FMMOs set the minimum prices for fluid milk (Class I differential plus the higher of Class III or Class IV), and via their being based on market-determined prices for cheese (Class III), butter and nonfat dry milk (Class IV), they set a minimum price each month to be paid to dairy farmers by handlers in the areas in which they apply. FMMO's have two effects: they raise farm-level prices higher than they would be without regulation (estimated system-wide at $388M or $.20 per hundredweight by Cox and Chavas in "An Interregional Analysis of Price Discrimination and Domestic Policy Reform in the US Dairy Sector", publication forthcoming) and they ensure wider, and therefore more equitable, sharing of revenues among farmers within the marketing area than would be the case without FMMOs.

That is why dairy farmers and their groups fight to retain the benefits that have accrued in their area and why those who have significantly less benefits are determined to "level the playing field". There is a perceived entitlement to the FMMO benefits that arise from high Class I differentials and these benefits take on the value of a vaguely defined property right. This phenomenon should not be allowed to continue and Congress should correct this in the next Farm Bill.

Despite the USDA reforms of FMMOs implemented on January 1, 2000, this program will continue to be unsettled because its benefits continue to be distributed inequitably on a regional basis. The majority of the nation's milk is now used in manufacturing and we have lost much of our ability to accomplish income enhancement on fluid milk without causing inequities. This means that in many respects FMMOs are outdated.

Appendix a shows a measure of the regional distribution of benefits to producers on a per hundredweight basis under the newly reformed orders. These benefits result from the minimum price guarantee on fluid milk sold by farmers in each region which is a function of the Class I (fluid milk) differential and the proportion of the region's milk that is used for fluid milk. Because the Class I differential and the percent of the total milk supply used for fluid milk varies by region (or FMMO marketing area), the benefits to producers vary from a low of approximately $.37 per hundredweight in the Midwest to a high of $3.63 per hundredweight in Florida. It would be difficult to call this program fair or providing a level playing field when the level of guarantee of fluid milk prices vary as they do.

Appendix b shows a plot of the Class I differentials for FMMOs (east of the Rocky Mountains) under the new reformed FMMOs compared to the previous. Although the tight correlation between the size of the Class I differential versus distance of Eau Claire has been reduced slightly there is still a significant correlation. Appendix b1 shows the relationship under USDA's final rule proposal, which was a more equitable distribution of differentials than those we have in effect due to Congress' intervention. This argues for further adjustments in the future if equitability is a standard to guide dairy policy.

Although USDA has done an admirable job with the reform process, their original reform proposal was better both in terms of regional equity and with balancing the economic relationships between the fluid and manufacturing sectors. Regardless of further direction from Congress, USDA will be busy trying to micromanage a complex regulatory program that ought to be in the long run much more simple.

Future direction in this program can only be to consolidate areas further in concert with the consolidation in the dairy industry and the commensurate widening in sourcing supply and distributing final products. National uniformity in pricing terms would ensure equity and fair competition. For too long California has operated to its advantage outside the FMMO program. Rather than tinkering further with FMMOs, the feasibility of adopting a California-like dairy program nationwide should be considered so that both fluid milk and manufacturing milk pricing could be more fully aligned. This would put all dairy farmers and all dairy plants on equal footing.

While California has had lower manufacturing prices than the rest of the nation, allowing that sector to grow rapidly, at the same time it has used high fluid milk prices to compensate farmers. Recent adjustments in California's program and the FMMO move the systems very close in function and form. Continued dual systems are likely to cause distortions down the road. Almost every other country approaches dairy price regulation from a uniform national perspective.

The lessons are that FMMOs cannot be structured to enhance Class I prices without depressing manufacturing prices, nor can they act as a dairy price support system. FMMO's should not be administered regionally, they must become a national uniform framework so that all dairy farmers have the same treatment and basis on which to compete using their natural advantages of efficiency, location, and access to markets.

Interstate Dairy Compacts

Extension of the Northeast Dairy Compact was a mistake. While it may bring short term benefits to farmers in New England states, its existence can only lead

Farm Level Impacts-Price

(No CCC BASE 97-$/cwt)

Region	*NE Compact*	*SE Compact*	*Combined NE/South*
Northeast	.66	-.14	.53
Southeast	-.06	1.35	1.32
Mideast	-.10	-.15	-.22
Upper Midwest	-.10	-.15	-.22
Southwest	-.05	.67	.58
California	-.08	-.15	-.22
USA	.06	.03	.09

to bad results for the nation's dairy farmers. Studies of the Compact provide sound evidence that production is increased, sales are decreased and the resulting extra milk adds to manufacturing milk supplies and lower prices in that sector. While Compacts bring short-term benefits to dairy farmers within the Compact, it reduces the prices of those outside the Compact. Two studies confirm this. One 1999 study by Tom Cox, Bob Cropp and Will Hughes, "Interregional Analysis of Interstate Dairy Compacts", UW Marketing and Policy Briefing Paper No. 69, shows the impacts on farm level milk prices by region under scenarios of the Northeast Compact (including NY and PA), a Southern Compact and the combined effects of a Northeast and Southern Dairy Compact. While the regions with Compacts benefit substantially, they do so at substantial costs to both producers outside the Compact areas and to consumers within the Compact area. Those producers outside the Compact lose primarily through reduced prices of cheese, butter and nonfat dry milk caused by the extra milk generated by the higher prices within the Compacts. A 1999 study by Ken Bailey and Jose Gamboa, "A Regional Economic Analysis of Dairy Compacts: Implications for Missouri Dairy Producers", Report #CA-160, January 1999, found very similar regional impacts. The tables presented here are from the Cox et.al. study.

Compact Impacts on Commodity Prices -US

($/cwt; expenditures in millions)

	NE Compact	SE Compact	Combined
Fluid *(expenditures)*	.32 ***+$148***	.38 ***+$178***	.70 *+$326*
Am. Cheese	-.70	-1.28	-1.74
Nonfat	-1.15	-1.76	-3.84
Net Expenditures	***+$92***	*+$77*	*+$172*

Both FMMOs and Compacts are indirect subsidies to manufacturing and are suspect by Europeans in trade negotiations. Using these programs to elevate fluid milk price levels cannot be done without lowering manufacturing prices and increasing inequities among farmers and among regions. I don't believe that is the type of policy that Congress wants to endorse.

The lesson is to eliminate regional dairy Compacts from the dairy policy tool box.

National Pooling and Reparation Payments

Economists can measure the benefit-cost distribution of programs. With the historical and current FMMOs we know that higher Class I differentials, differing by location, results in lower manufacturing prices. Compacts do the same. There is justification for nationally pooling a portion of all Class I differential proceeds in order to improve equity. This course has not been agreeable in the past, but some level of national pooling should be examined again. Alternatively, because the benefit distribution of FMMOs and Compacts have been so tilted against manufacturing areas in favor of fluid milk areas, there would also be justification for some form of reparation payment. The source for the reparation should be from the Class I proceeds in the high differential markets.

I point this out because there comes a point at which better means for sharing the benefits of these programs must be found or the programs will self-destruct in the future.

Dairy Price Supports

Dairy price supports are a reasonable stop-gap measure to take the sting off the very low prices as we are seeing now. Price supports, if set routinely too high, give incentives to build plants based on artificial economics, and dairy farmers turn on production. Too high supports remove market risks; lower level supports help during real low periods but they do not give artificial expansion signals to either dairy producers or dairy plants, which come back to haunt the dairy industry with burdensome surpluses. We have proof of how this has worked in practice in recent history. Price supports at current benefit farm prices by about $.05 per hundredweight or $100m in aggregate according to modeling by Cox at UW-Madison.

Direct Payments

Two rounds of relatively small direct payments have been provided to dairy farmers in the past year. These were short-term methods to help target some additional cash to dairy farmers, and they included a maximum hundredweight per farm to which the payments could be applied.

Direct payments have several advantages that suggest further consideration as a more permanent safety net program: 1) it puts dairy on a similar track as other commodities that are supported by government; 2) it allows putting limitations on payments to control budget exposure and to target benefits; and 3) they are the least distorting to markets and therefore the most equitable and effective of the policy tools available.

I recommend that direct payments be considered as an on-going tool to help dairy farmers manage low price periods. Payment levels should be tied to price levels in a prior, recent period, total dollar limitations should be placed on the amount any one farm can receive in a period, and perhaps some additional incentive could be provided to those who are not increasing production in down price cycles. In the future, a variation of this type of program could replace FMMO's.

Because price volatility will remain a factor additional tools to support risk management or revenue assurance should be considered whereby farmers could choose among private and public tools to better manage risk.

These are programs that suggest there is a role for government in aiding the dairy industry. That role needs to change with more direct forms of support targeted to more transparent purposes for which dairy programs exist.

The following table is my attempt to summarize my thought and recommendations for future dairy policy.

Thank you for the chance to provide these thoughts.

Dairy Programs	*National or Regional*	*Equitable*	*Responsive to Supply/Demand*	*Future Course*
Current				
Dairy Price Supports	National	Yes	Yes, when kept at safety net level	Keep in some form
DEIP	National	Yes	Yes	a. Keep in some form b. Align with trade outcomes
FMMO	Fluid-Regional Mfg-National	No- See Appdx a	Yes, but Fluid less than Mfg	a. Uniform National Program e.g. like California b. Deregulate
Dairy Compacts	Regional	No- outsiders lose -see Cox	No	Eliminate
Future Possible Programs				
Revenue Assurance	National	Yes	Yes	Premiums tied to protection level
Direct Payment Safety Net	National	Yes	Yes	Payments levels tied to price/ payment limits/ incentives for balancing supply/demand

Table 1a: Percent of U.S. Herds by Size, 1988 & 1998

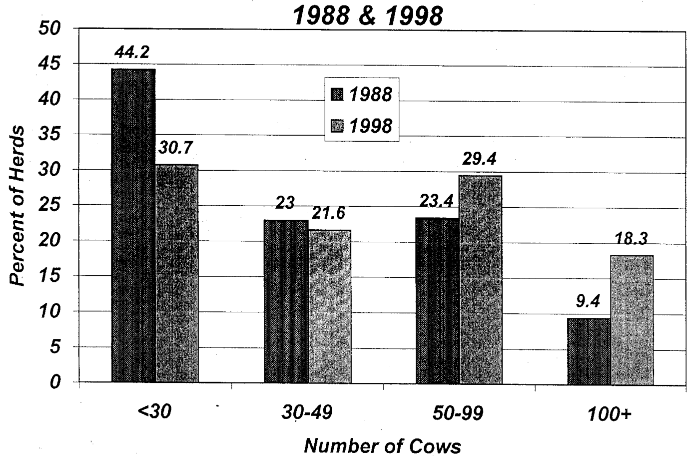
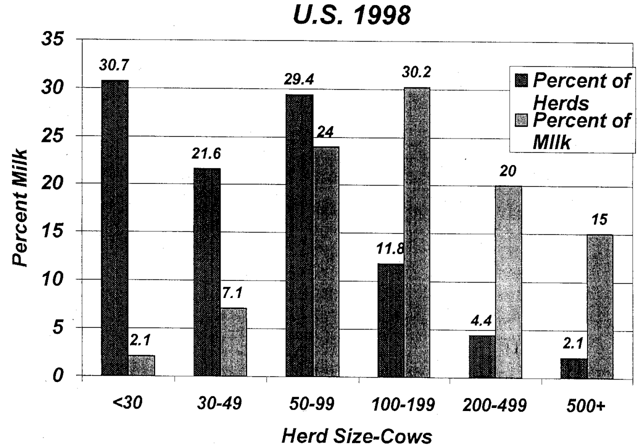
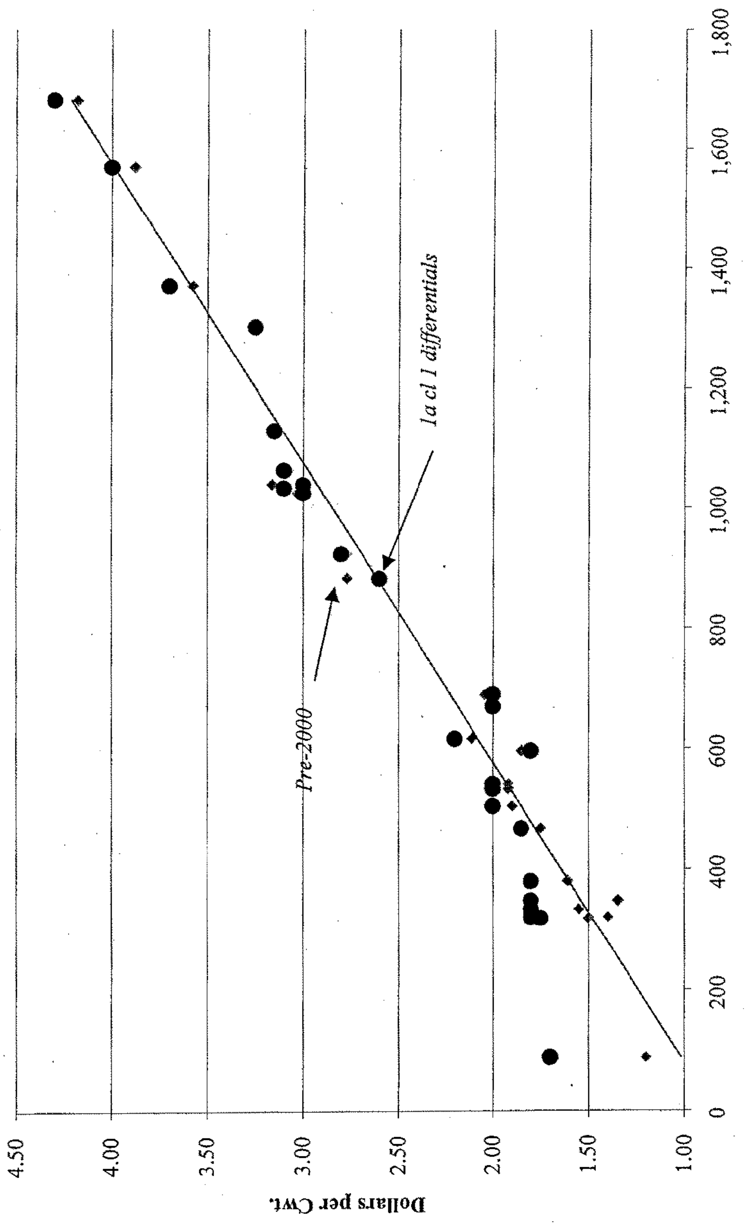


Table 1b: Percent of Herds and Milk, By Size, U.S. 1998



Appendix b
Class I Differentials *vs.* Distance from Eau Claire



Appendix b1
Class I Differentials *vs.* Distance from Eau Claire

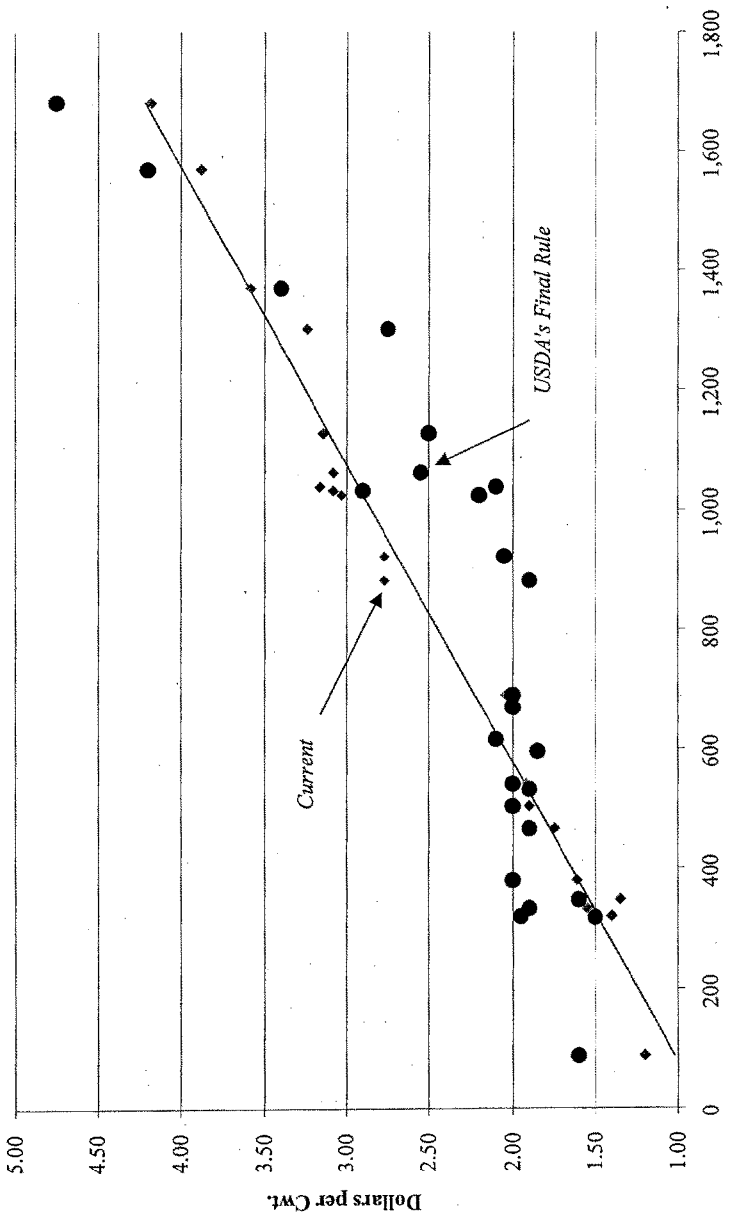
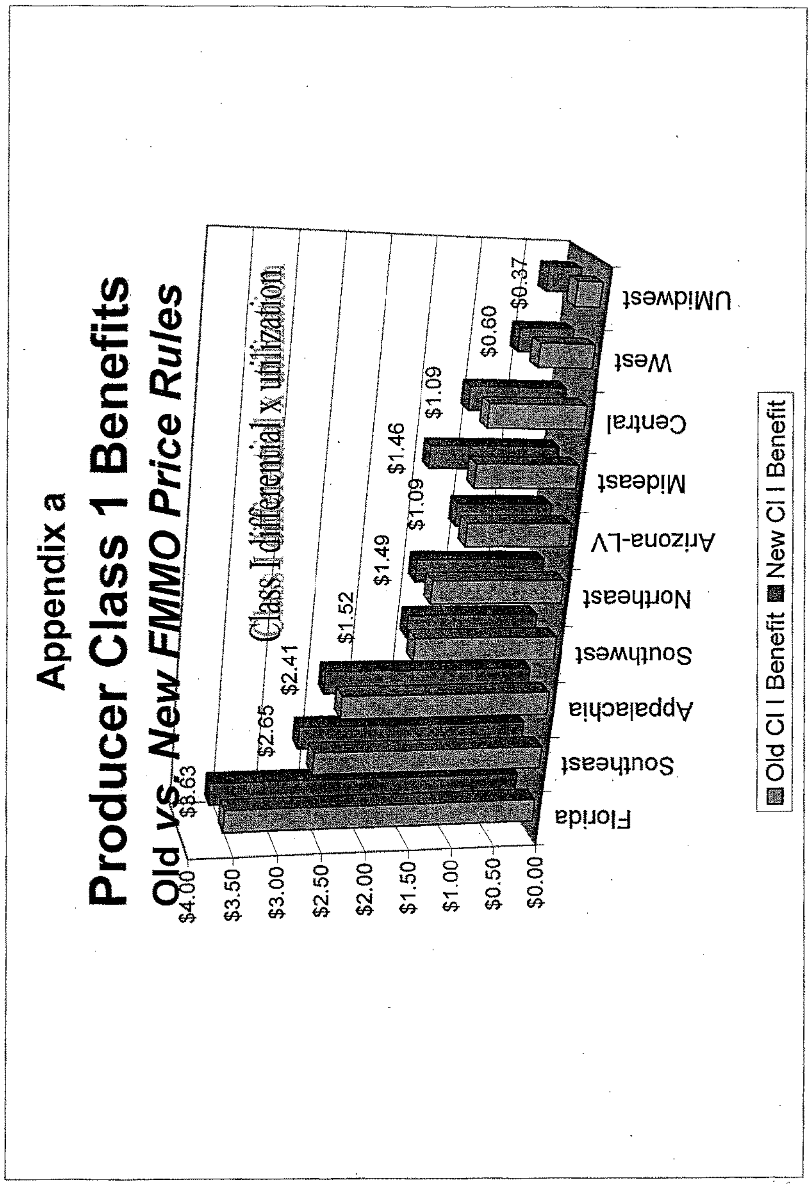


Table 2- Vermont vs US Farm Loss 97-99

Size of herd	Vermont 99 vs.97	US 99 vs. 97
1-29	-70 (-35%)	-6760 (16.3%)
30-49	-90 (-22%)	-3690 (-13.4%)
50-99	-50 (-5.4%)	-2500 (-7.0)
100-199	-30 (-8.5%)	-1085 (-7.6%)
200-499	+30 (30%)	+296 (5.8%)
500+	+10 (50%)	+219 (9.4%)
Total	(-5.2%)	(-5.1%)



Appendix a
Producer Class 1 Benefits
Old vs. New FMMO Price Rules
Class I differential x utilization
$4.00
$3.50
$3.00
$2.50
$2.00
$1.50
$1.00
$0.50
$0.00
$3.63
$2.65
$2.41
$1.52
$1.49
$1.49
$1.09
$1.46
$1.09
$0.60
$0.37
Florida
Southeast
Appalachia
Southwest
Northeast
Arizona-LV
Mideast
Central
West
UMidwest
Old Cl I Benefit
New Cl I Benefit

STATEMENT OF

NATIONAL FARMERS ORGANIZATION

2505 ELWOOD DRIVE

AMES IA 50010

515-292-2000

SENATE AGRICULTURAL COMMITTEE

PRESENTED BY

EUGENE PAUL

FEBRUARY 8 - 9, 2000

My name is Gene Paul. I am the Legislative Coordinator for the National Farmers Organization in Ames, Iowa.

The National Farmers Organization represents independent producers nationwide in negotiating contracts and other terms of trade for grain, livestock and dairy. We are in the marketplace doing so on a daily basis. The specific purpose is to help independent farmers extract the dollars they need to cash flow their operations, pay their expenses and earn a living from what they produce and sell.

Today, dairy farmers in this country are facing devastating times. The current dairy policies have brought chaos to the dairy industry. Since September 1999 the Basic Formula Price for milk received by dairy producers has decreased from $16.26 to the latest BFP announcement for December 1999 milk of $9.63 per hundredweight.

This is over a forty percent drop in milk price. How can a dairy business function with this degree of volatility? Like all businesses, dairy farmers need to have a stable and equitable market price. The milk price today is far below the milk production costs experienced by dairy producers in this country. Dairy farmers cannot develop an effective business plan for their operation under these conditions.

The turmoil of America's dairy industry due to the past and current dairy policy is very plain to see, looking at the exodus of dairy operations over the past years. In 1992 there were 131,535 commercially operating dairy farms. In 1999 the number decreased to 87,669 farms. Over this seven year period of time 43,866 dairy operations went out of business. Simply put, one-third of America's dairy operations from 1992 to 1999 went out of business and stopped selling milk, and with that had a negative impact on the rural businesses and infrastructure.

The newly implemented USDA reform of dairy pricing only furthers the chaos facing the dairy industry. USDA's dairy pricing reform leveled the field of milk pricing to the lowest level found for milk in the country. The dairy pricing reform was designed to function like California's state order pricing system. An economic analysis of the pricing reform shows that the milk price to be received by dairy producers will be lower under the new reform than the price generated by the Basic Formula Price. The gains from being competitive with California's milk pricing system can not be worth the further demise of this nation's dairy industry.

The majority of America's milk production is being utilized for the production of dairy products. However, a great deal of focus has been placed on Class I milk, which is milk processed for fluid consumption. Class I differentials are important, but, most of the milk is used for the manufacturing of cheese priced in Class III. Today's reform of America's milk pricing system is not truly market oriented or fair to dairy producers.

USDA's new dairy pricing system and the California state order milk prices are set using end product pricing formulas to establish the value of milk to be used for the manufacturing of cheese, butter and powdered milk. End product pricing formulas alone do not find the true value of raw milk. Raw milk has a value before it is processed into a dairy product. Raw milk's value is the cost to produce the milk, such as hay, grain, equipment, utilities, and labor.

Another major issue with end product pricing is the setting of a make allowance level. Make allowances assist the milk processors in covering the production costs of the plants, whereas, the milk producing segment of the industry receives no production cost consideration at all.

Make allowances tend to become obsolete rapidly allowing for plant inefficiency and interfere with market signals. The California end product pricing system is an example of this point. California allowed plants to be profitable and expand processing of the lowest value dairy products regardless of market demands resulting in lower producer milk prices. Processors with a generous make allowance level use this margin to discount the product price to gain market share and thus further lowering the end product price at the expense of producer pay prices.

A true market oriented milk pricing system would allow processors to be effected by market signals and would not protect the milk processing segment of an industry any more than the milk producing segment of the dairy industry. Make allowances give milk processors a consideration that milk producers do not receive. A fair milk pricing system would give some type of milk production allowance consideration in determining the fair value of milk.

Many people have been told that the dairy industry can export or trade its way to a healthier condition. This idea has been the "fix all, save all" remedy for what ails the dairy industry. However, a recent economic report on this issue from the University of Wisconsin titled "An Economic Analysis of the Effects of GATT and Trade Liberalization on the World Dairy Sector" shows the fallacy in export salvation for America's dairy industry. The report predicts the direction and amount of milk price change for America's dairy producers as a result of free trade to be a negative .4 percent. The report results may vary slightly in terms of amount of change, however, the direction of change is certain. Basically, chasing freer trade for the dairy industry will result in lower milk prices for America's dairy producers. This scenario can not be viewed as a winning solution.

Some dairy leaders look at the Canadian market as a market to be opened and conquered by this country's dairy industry. All this would do is basically lower the Canadian dairy producer's milk price to an inequitable level. Canada's dairy industry program should not be targeted for destruction by this country; it should be envied by the United States. The Canadian dairy policy allows for dairy producers to receive an equitable milk price that covers costs. The gain to America's dairy producers by ruining Canada's current dairy system would be minimal, if any gain at all. The United States needs to establish dairy policy that allows for an equitable dairy industry instead of looking at destroying another countries' equitable dairy industry.

To provide some stability in milk prices National Farmers Organization supports the Northeast Dairy Compact Commission, the expansion of the compact and the creation of similar entities.

A dairy industry milk reserve management program has many benefits and should be given an opportunity in the United States. We encourage a mandatory system, however, a voluntary system could be established with the cooperation of dairy producers and dairy cooperatives using a coordinated and systematic culling of producing cows.

At this time, National Farmers Organization is requesting emergency action be taken by USDA pursuant to the Agricultural Marketing Agreement Act of 1937 (AMMA), as amended, to establish a floor price for the price of milk in all federal milk marketing orders. National Farmers Organization is calling on the

USDA to fulfill their duty and obligation under the Agricultural Marketing Agreement Act of 1937 to establish orderly marketing conditions and price stability by initiating emergency rulemaking proceedings to institute a milk floor price of $13.50 per hundredweight for Class III milk.

The economic situation facing America's dairy producers today must be addressed. Without quick action in the form of price relief, which National Farmers Organization has requested, financial disaster will plague America's dairy producers causing many more to exit the industry.

NATIONAL FARMERS UNION

STATEMENT of

BILL BREY, PRESIDENT
WISCONSIN FARMERS UNION

on behalf of the

NATIONAL FARMERS UNION

presented to the

SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

"THE NEED FOR FEDERAL DAIRY POLICY"

FEBRUARY 9, 2000

WASHINGTON, D.C.

400 North Capitol Street, N.W. • Suite 790 • Washington, D.C. 20001 • Phone (202) 554-1600

Statement of Bill Brey, President of the Wisconsin Farmers Union, on behalf of the National Farmers Union, presented to the Senate Committee on Agriculture, Nutrition and Forestry, regarding the Need for Federal Dairy Policy, on February 9, 2000, in Washington, D.C.

On behalf of the 300,000 farm and ranch families of the National Farmers Union, I would like to thank you for the opportunity to testify. I am Bill Brey and I serve as president of the Wisconsin Farmers Union. I am a full time dairy farmer from Sturgeon Bay, Wisconsin, where I farm with my wife and family. We milk 95 cows and raise 600 acres of alfalfa, corn, barley, canning peas, and soybeans.

Many people would say that Wisconsin is ideally suited to produce milk. Yet, nowhere is the economic devastation brought on by low prices more evident. My state has dropped from over 40,000 dairy farms in the 1980's to just 21,000 dairy farms as of January 1, 2000. With prices hovering between $9.00 and $10.00 per cwt., farmers will continue to be put out of business.

National dairy policy has become very contentious with one region pitted against another. However, it is the strong belief of the members of National Farmers Union that only by working together can we move forward to a national solution.

I have worked to implement this strategy in my home state. When we made plans for our annual Wisconsin Farmers Union convention, which occurred on February 4-5, I invited producers from all regions of the country to participate on a national dairy producer panel. Our panel included dairy farmers from Vermont, Alabama, Texas, Minnesota, California, and Wisconsin.

My testimony today will include two sections: 1) National Farmers Union's support for continuation of dairy policy at the federal level, and 2) the principles of agreement reached by panel participants.

NATIONAL FARMERS UNION POSITION

National Farmers Union believes there is a strong need for federal dairy policy. NFU supports continuation of the federal milk market order system, the dairy price support system, dairy nutrition programs, and dairy export programs.

Federal Milk Market Order System

While the federal milk market order system is not perfect, it provides important protection for both producers and consumers. The system provides testing and standards and helps ensure the orderly marketing of dairy products throughout the United States. It ensures producers are paid for the product they deliver. It has provided consumers with a safe and healthful supply of dairy products wherever they live.

We believe some changes are needed. National Farmers Union supports reform of the federal milk market order system on Class III and IV, as directed by Congress. In particular, we are concerned that the new, higher processor manufacturing allowances set by USDA will result in less producer income. Farmers are questioning why processors should receive a guaranteed "cost of production" for manufacturing, even while farmers are left at the mercy of the market. We are considering the benefits of a variable manufacturing allowance that would adjust in relationship to the producers' milk price.

Dairy Price Support Program

The dairy support price sets a floor on the price received by all producers, regardless of region and regardless of how each producer's milk is used. National Farmers Union favors a dairy price support program that is set at a level sufficient to curb market volatility. The current level of $9.90 per cwt. is too low to act as a stabilizer. (See the attached graph on page 5, which shows that the support price was an effective price stabilizer, until the late 1980's, when it was reduced too far below the average market level.)

The five-year average base price for milk, i.e., the basic formula price, is $12.78 per cwt. Therefore, our members believe a support price of $12.50 per cwt. would protect against the huge drops producers have experienced in the past few years. Commodity Credit Corporation purchases may need to be capped to limit government costs and avoid surplus product.

A stable supply benefits processors by keeping plants operating at capacity levels. Decreased volatility would also benefit consumers who pay more when farm prices increase, but seldom see a corresponding decrease when farm prices go back down.

Immediate Relief

In the short-term, immediate action is necessary to help producers survive the extraordinarily low market prices producers are currently facing. This could be provided in a number of ways. Congress could authorize a temporary support price increase, set at a level that would allow the Commodity Credit Corporation to remove current surpluses until the price recovered.

In the absence of policy to help producers earn their income from the market, additional emergency payments should be considered. We appreciate the $125 million appropriated by Congress in last fall's emergency funding. However, assuming that funding is distributed in a manner similar to 1999, this year's payments are likely to be in the range of 14 cents per hundredweight, with a maximum of $3,600 for any producer. This would be a payment of approximately $1,486 for the average Wisconsin producer. The feed alone for that same size producer costs about $7,000 for just one month. Since USDA is projecting a significant drop in dairy producer income for the year 2000, emergency assistance will be more important than ever.

Dairy Compacts

Our members have called for a nationwide solution that will enhance opportunities for all dairy farmers, regardless of region. National Farmers Union will support dairy compacts to the extent they are coupled with a support price that is high enough to stabilize price and enable producers to earn a fair return from the market.

National Dairy Trade Policy
There is often discussion about whether various U.S. dairy programs are allowable under the World Trade Organization and how our programs will affect the United States' ability to negotiate future agreements. We would point out that U.S. farmers produce 160 billion pounds of milk per year and export only 3 billion pounds. Since the lion's share of our milk, 98.2 percent, is sold in the United States, it is imperative that the United States maintain its ability to operate domestic programs for food security. There is no financial advantage in supporting policy that lowers the market price to producers on 98.2 percent of the milk just to increase exports.

In addition, since the world market is heavily subsidized, we support maintaining the Dairy Export Incentive Program (DEIP).

Food and Drug Administration Standards
National Farmers Union members are very concerned about the current petition by processors that asks FDA to change the definition of natural cheese, thereby allowing the use of imported milk protein concentrate, which would displace domestic milk used for manufacturing, resulting in greater program costs and lower prices to dairy farmers.

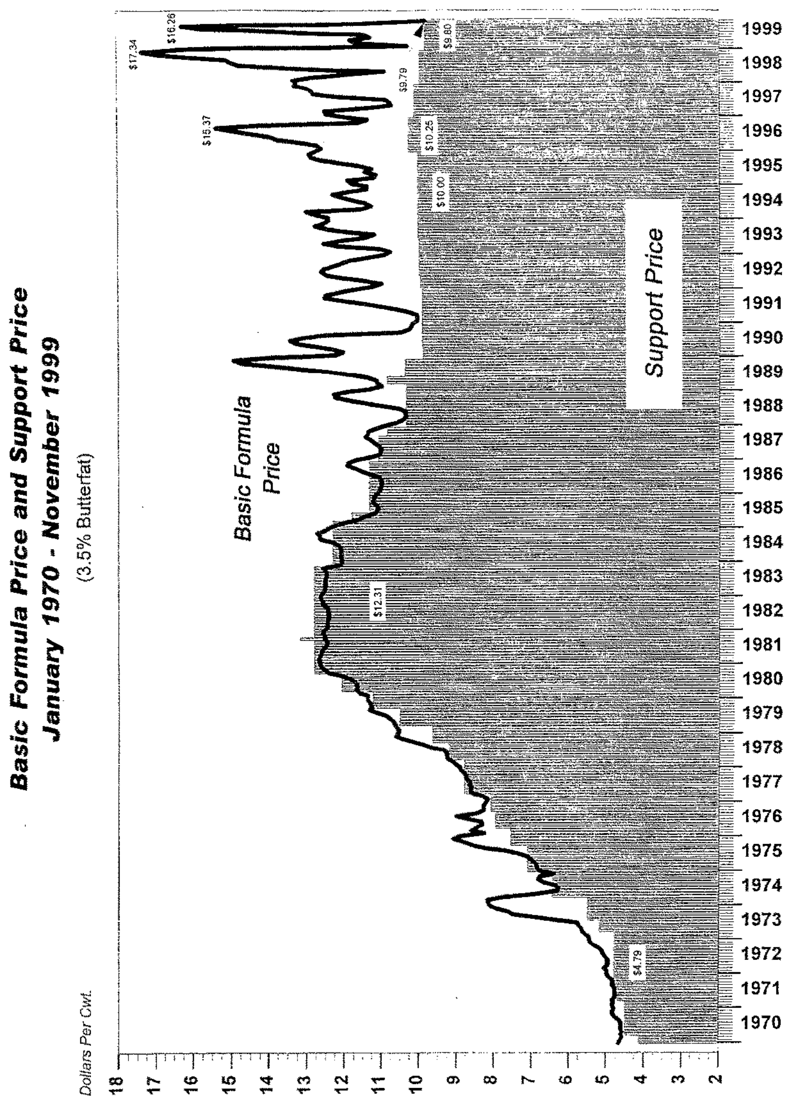
Regional disagreements have caused some people to ask whether total deregulation would be preferable to maintaining national policy. However, we believe the benefits provided by a federal dairy program far outweigh the items of contention.

NATIONAL DAIRY PRODUCER PANEL

On February 5, the Wisconsin Farmers Union convened a panel of eight dairy producers from across the nation. The panel included both Farmers Union members and those who were members of other farm organizations. We specifically included a representative who was instrumental in establishing the Northeast Compact. The panel also included a member who was interested in establishing a southern compact. The panel also included farmers who had large farms and those with small farms. We found that even with these differences, there were many areas of agreement. (The points of agreement reached by participants on our national panel are attached as page 6.)

We plan to have future dialogue with our producer representatives and want to come to Washington D.C. as a team to discuss dairy with Members of Congress.

In conclusion, I would urge Congress to try the same strategy. Only when we overcome our regional differences and work together for a national solution can we achieve successful policy. Once again, thank you for the opportunity to present this information.



NOTE: Prior to May 1995, the Basic Formula Price (BFP) was known as the Minnesota - Wisconsin (M-W) price.

NATIONAL DAIRY PANEL - POINTS OF AGREEMENT
Panel convened on February 5, 2000
Eau Claire, Wisconsin

All members of the panel agreed that dairy producers are facing a serious economic problem.

- Current support price is at a level too low to stop volatility.
- In most areas of the country dairy prices are too low to sustain viable family farms. This is resulting in the loss of individual ownership. Too often, ten farms owned by ten farmers are becoming one farm with one owner and many indigent employees.
- The new manufacturing allowance is a concern. The higher manufacturing allowance will reduce producer income, particularly at a time when the producer price is low.

PRINCIPLES OF AGREEMENT AS TO THE SOLUTION

We support maintaining a federal dairy program, including the federal milk market order system, the federal dairy price support, and the Dairy Export Incentive Program.

Any longterm solution has to incorporate some type of supply management.

Federal dollars will provide the maximum benefit to dairy farmers if funding is targeted toward buying excess commodities rather than used for direct payments to individual farmers. However, until the federal dairy program is amended to improve the balance between supply and demand, thus enabling dairy farmers to earn their income from the market, direct payments help provide limited, temporary relief.

In negotiating trade agreements, we must maintain our ability as a nation to continue domestic programs for food security.

Societal demands placed on family farmers, including the cost of compliance with rules and regulations, should be shared by all citizens.

We support increasing dairy farmers' income through a comprehensive dairy program. We support compacts when they are coupled with an increased support price. The current support price at $9.90 per cwt. is too low.

The national milk standard for solids-not-fat should be increased from the current level of 8.2 percent.

We urge the Food and Drug Administration to maintain the current standards for natural cheese.

Response to Question Raised at February 9, 2000 Senate Agriculture Hearing

Question by Senators Daschle and Conrad: Can USDA provide a comparison of the regional impacts of the Final Decision, Modified Option 1A, and Modified Option 1B Class I pricing options?

Answer: The attached tables show the impacts of the Final Decision Class I prices and the alternative options 1A and 1B. These results are comparisons to USDA's official baseline, which provides a supply-demand-price forecast for the U.S. dairy sector for the six-year period covering 2000-2005. Impacts are shown for the marketing order regions as they existed prior to the consolidation under FMMO reform in the Final Decision.

Impact on Federal Order Cash Receipts

Overall Impact – USDA's baseline forecast for annual average cash receipts for the period 2000-2005 total nearly $17 billion. Under the Final Decision, cash receipts were forecast to decrease by about $2.8 million per year. Under Modified Option 1A, cash receipts were forecast to increase by about $105 million per year. Under Modified Option 1B, cash receipts were estimated to decline by nearly $128 million per year.

Regional Impacts – Compared with baseline forecasts, under the Final Decision 17 of the existing marketing order areas before consolidation could experience modest declines in cash receipts while 15 orders are forecast to realize higher annual cash receipts. Under Modified Option 1A, cash receipts were forecast to increase in 16 marketing order areas, decline in 15 marketing orders, and one order was forecast at no change. Under Modified Option 1B, 21 marketing order areas were forecast to experience lower annual average receipts, and 11 were forecast to experience higher cash receipts.

Impact on Federal Order All-Milk Prices

Overall Impact – The all-milk price is a weighted average, calculated as the product of the forecast minimum price for milk in each class (Class I, II, III, and IV) and the amount of milk used in each class. The average all-milk price under the baseline forecast for 2000-2005 is estimated at $15.23 per hundredweight (cwt). Compared with the pricing options, the all-milk price if forecast lower under the Final Decision (by $0.02 per cwt), higher under Modified Option 1A (by $0.03 per cwt), and lower under Modified Option 1B (by $0.10 per cwt).

Regional Impacts – Under the Final Decision, 13 order areas could see increases in the all-milk price, and 18 orders could see lower all-milk prices, and one order is forecast at no change from the baseline all-milk price. Under Modified Option 1A, 17 marketing orders would have seen declines in all-milk prices, while 15 orders would have seen higher all-milk prices. The all-milk price was forecast to decline for 22 orders under Modified Option 1B, and increase in 10 orders.

Table 1. Change from Baseline in Annual Average Cash Receipts (Million $)

FMMO Region	USDA Baseline 6-Yr Average	Final Decision	Modified 1A	Modified 1B
Northeast				
New England	$ 879.8	$ 1.2	$ 4.4	$ -5.0
NY-NJ	1,784.9	18.7	48.4	5.5
Mid-Atlantic	1,046.9	-39.5	-10.3	-46.7
Unreg'd NY, NE	74.0	-2.5	-2.2	-3.0
Appalachian				
Carolina	508.2	-6.5	6.6	-14.1
Tennessee Valley	243.8	-4.4	2.0	-8.1
Louis-Lex-Evansv	185.9	-1.2	-0.5	-4.1
Southeast	942.5	0.3	6.1	-14.1
Florida				
Upper Florida	67.6	-0.3	-0.8	-1.3
Tampa Bay	340.5	12.2	7.7	7.0
S.E. Florida	243.1	7.1	0.2	3.6
Mid East				
MI Upper Pen.	10.6	-0.2	0.0	-0.3
So. Michigan	688.7	14.1	8.2	6.9
E.OH.-W.Penn	503.2	9.3	7.2	4.3
Ohio Valley	477.7	3.5	1.7	-1.0
Indiana	316.8	0.3	-0.9	-2.6
Upper Midwest				
Chicago Regional	1,904.4	43.1	14.3	38.5
Upper Midwest	1,258.0	-8.7	1.9	-7.5
Central				
Iowa	392.1	17.5	6.0	14.1
NB.-W.Iowa	245.7	6.7	-0.4	4.6
E.-So. Dakota	34.8	-0.4	-0.5	-0.6
Central Illinois	31.3	-0.4	-1.3	-0.6
S.Il-E. Missouri	306.6	2.6	-4.6	0.2
S.W. Plains	472.3	-11.3	5.5	-15.2
E. Colorado	296.5	-11.4	7.8	-13.9
W. Colorado	20.8	-0.4	-1.1	-0.6
Greater KS City	49.1	-2.0	-2.4	-2.4
Southwest				
Texas	1,002.2	-39.7	-5.7	-48.4
N. Mex-W. Texas	341.6	5.7	6.3	2.6
Western				
S.W. Idaho-E.Or	358.8	7.2	5.8	6.0
Great Basin	384.4	-7.9	-4.6	-9.1
AZ-Las Vegas	428.1	-10.4	-1.4	-13.4
Pacific Northwest	1,103.7	-5.4	1.6	-9.7
All Federal Orders[1]	16,944.5	-2.8	104.9	-128.7

[1] Six-year simple average over the period 2000-2005; does not reflect termination of transportation credit in New York-New Jersey, and excludes income from additional pooled milk in the Upper Midwest for the Final Decision and Modified Option 1A due to price.

Table 2. Change from Baseline in All-Milk Prices Under Pricing Options ($/cwt)

FMMO Region	USDA Baseline 6-Yr Average	Final Decision	Modified 1A	Modified 1B
Northeast				
New England	$15.54	$.01	$.05	$-.07
NY-NJ	15.00	.15	.34	.06
Mid-Atlantic	15.53	-.47	-.13	-.55
Unreg'd NY, NE	14.84	-.40	-.36	-.49
Appalachian				
Carolina	17.08	-.18	.16	-.38
Tennessee Valley	16.78	-.25	.09	-.45
Louis-Lex-Evansv	16.14	-.10	-.05	-.30
Southeast	16.57	-.01	.07	-.21
Florida				
Upper Florida	19.06	-.08	-.18	-.30
Tampa Bay	18.88	.50	.31	.28
S.E. Florida	19.94	.42	.00	.21
Mid East				
MI Upper Pen.	15.91	-.28	-.03	-.40
So. Michigan	15.01	.23	.13	.11
E.OH.-W.Penn	15.32	.22	.17	.10
Ohio Valley	15.74	.08	.03	-.04
Indiana	16.04	.00	-.05	-.12
Upper Midwest				
Chicago Regional	14.44	.16	-.02	.22
Upper Midwest	14.27	-.09	-.03	-.07
Central				
Iowa	14.70	.52	.17	.42
NB.-W.Iowa	15.04	.33	-.02	.22
E.-So. Dakota	15.31	-.13	-.19	-.24
Central Illinois	16.49	-.17	-.57	-.27
S.Il-E. Missouri	15.71	.10	-.20	.00
S.W. Plains	15.39	-.31	.13	-.41
E. Colorado	14.84	-.48	.32	-.58
W. Colorado	15.39	-.25	-.66	-.36
Greater KS City	16.45	-.56	-.66	-.66
Southwest				
Texas	15.66	-.50	-.08	-.61
N. Mex-W. Texas	14.47	.20	.22	.09
Western				
S.W. Idaho-E.Or	13.80	.23	.19	.19
Great Basin	14.51	-.26	-.15	-.29
AZ-Las Vegas	14.70	-.30	-.04	-.38
Pacific Northwest	14.43	-.06	.01	-.11
All Federal Orders	15.23	-.02	.03	-.10

TESTIMONY OF DEBORA A. ERB FOR THE SENATE AGRICULTURE, NUTRITION AND FORESTRY COMMITTEE HEARING ON REVIEW OF THE FEDERAL DAIRY PRICING SYSTEM

MY NAME IS DEBORA ERB. MY HUSBAND AND I OWN AND OPERATE A REGISTERED HOLSTEIN DAIRY FARM IN LANDAFF, NEW HAMPSHIRE. WE CURRENTLY MILK 120 COWS. I ALSO SIT ON THE NORTHEAST DAIRY COMPACT COMMISSION. MY TESTIMONY IS BASED ON PERSONAL EXPERIENCE WITH THE DAIRY INDUSTRY AND THE WORKINGS OF THE NORTHEAST DAIRY COMPACT (COMPACT).

THE COMPACT HAS DONE WHAT IT SET OUT TO DO. IT HAS PROVIDED A SAFETY NET FOR FARMERS. IT HAS STABILIZED CONSUMER RETAIL PRICES. IT HAS HELD HARMLESS GOVERNMENT PROGRAMS SUCH AS WOMEN, INFANTS AND CHILDREN NUTRITION PROGRAM, THE COMMODITY CREDIT CORPORATION AND REIMBURSED SCHOOL LUNCH PROGRAMS FOR ANY COSTS INCURRED FROM THE COMPACT PRICE. AND, IT HAS SLOWED FARM ATTRITION IN NEW ENGLAND.

WHEN THE PRICE TO THE FARMER FALLS BELOW THE COMBINED COMPACT AND FEDERAL MINIMUM PRICE OF CLASS I OR FLUID MILK, THEN THE COMPACT PRICE GOES INTO EFFECT. WHEN THE PRICE TO FARMERS FOR CLASS I RISES ABOVE THE COMPACT SET PRICE, THE COMPACT HAS NO EFFECT. THIS IS A COUNTER-CYCLICAL PAYMENT THAT DOES NOT USE TAX DOLLARS. THE COMPACT TAKES OUT THE LOWS AND HELPS EVEN OUT THE PRICE TO THE FARMERS. THIS HELPS IN BUDGETING AND PLANNING.

THE RETAIL PRICE TO THE CONSUMER HAS STABILIZED. BY SETTING THE COMPACTS FLOOR PRICE AT $16.94 PER HUNDREDWEIGHT FOR CLASS I MILK IN JULY 1997 AND KEEPING IT THERE FOR THE SUBSEQUENT TWO AND A HALF YEARS, PRICE CHANGES HAVE MODERATED. THERE WAS AN INITIAL PRICE HIKE IN JULY 1997 DUE TO THE WELL-PUBLICIZED ANNOUNCEMENT OF THE COMPACT PRICE THAT WAS ANTICIPATED BY PROCESSORS AND RETAILERS. SUBSEQUENTLY, COMPETITION BEGAN TO COME INTO PLAY AND PRICES MODERATED. DURING THIS TIME, PRICES IN THE REST OF THE COUNTRY ROSE AND PASSED NEW ENGLAND RETAIL PRICES. THE MOMENT FARM PRICES GO UP, THE RETAIL PRICE IS MOVED UP. BUT RETAIL PRICES LAG CONSIDERABLY WHEN FARM PRICES GO DOWN. BY THIS MEANS RETAIL PRICES CONTINUE TO GO UP WHILE FARM PRICES GO UP AND THEN DOWN. BY SMOOTHING THE TREND LINE OF THE FARM PRICE, THE PRICE HIKES BY RETAILERS ARE MITIGATED. THE RATCHETING EFFECT HAS CONTINUALLY WIDENED THE GAP BETWEEN WHAT CONSUMERS PAY AND WHAT FARMERS RECEIVE. IN 1980, THE DAIRY FARMER GOT $.53 OF EVERY DOLLAR SPENT ON A GALLON OF FLUID MILK. BUT BY 1998, THE FARMER'S SHARE HAD DECLINED TO $.37. THIS EVER INCREASING PRICE VOLATILITY WORKS TO THE ADVANTAGE OF THE MIDDLEMAN AT THE EXPENSE OF BOTH FARMER AND CONSUMER.

WE HELD A HEARING AT THE COMMISSION WHERE A PROCESSOR TESTIFIED THAT HIS COMPANY DID NOT LIKE THE COMPACT BECAUSE IT DECREASED THEIR PROFIT. THEY COULD NOT INCREASE THE PRICE OF CLASS I MILK BECAUSE THE COMMISSION HAD SET IT AND NOT MOVED IT. DUE TO THE COMPETITION IN THE MARKET PLACE HIS COMPANY WAS UNABLE TO RAISE THE PRICE IN THE RETAIL STORE.

THE COMMISSION IS SUCCESSFUL BECAUSE OF THE WAY IT IS PUT TOGETHER. PEOPLE WITH EXPERTISE IN ALL AREAS OF THE DAIRY ECONOMY SERVE ON THE COMMISSION AND BRING THIS EXPERIENCE TO BEAR ON THE DECISION-MAKING PROCESS. AT THE SAME TIME THAT THE INTERESTS OF CONSUMERS, PROCESSORS AND PRODUCERS ARE REPRESENTED ON THE COMMISSION, THE VOTING PROCEDURES - EACH STATE DELEGATION CASTS A SINGLE VOTE – MEAN THAT NO ONE INTEREST CAN HOLD SWAY. THIS PROCESS MAKES FOR A LENGTHY DECISION-MAKING PROCESS BUT THAT ONLY MEANS EACH ACTION IS BACKED BY CAREFUL AND THOUGHTFUL DELIBERATION WITH BROAD INTERESTS BEING CONSIDERED.

A RECENT AMERICAN FARM BUREAU FEDERATION STUDY SHOWED THE FARM ATTRITION RATE FOR NEW ENGLAND IS LOWER THAN THAT OF THE REST OF THE COUNTRY. THIS WAS ONE OF THE GOALS OF THE COMPACT. THE WHOLE REGION BENEFITS WHEN FARMLAND IS KEPT IN PRODUCTION. WHEN A FARM GOES OUT OF PRODUCTION IN THE NORTHERN PART OF NEW ENGLAND, IT GROWS UP TO SCRUB. BUT WHEN A FARM GOES OUT IN THE SOUTHERN AREA, HOUSING DEVELOPMENTS AND SHOPPING MALLS REPLACE IT. BOTH RESULTS MEAN THAT THE LOSS OF THE WORKING LANDSCAPE AND OPEN LAND ARE FELT BY ENVIRONMENTAL GROUPS, SPORTSMAN GROUPS, AND FARM RELATED BUSINESSES OF THE RURAL ECONOMY.

THE COMPACT HAS DONE WHAT IT SET OUT TO DO. IT HAS PROVIDED A SAFETY NET FOR FARM MILK PRICES. IT HAS STABILIZED RETAIL PRICES FOR CONSUMERS WHILE HOLDING HARMLESS GOVERNMENT FOOD PROGRAMS THROUGH REIMBURSEMENTS FOR WIC AND SCHOOL LUNCH PROGRAMS. AND, SIGNIFICANTLY FOR THE FUTURE OF THE REGION, IT HAS SLOWED THE RATE OF FARM ATTRITION IN NEW ENGLAND WITHOUT DRIVING UP THE COST OF MILK TO THE CONSUMER.

THANK YOU,

Debora A. Erb

DEBORA A. ERB
DAIRY FARMER
546 MILLBROOK RD.
LANDAFF, NH 03585-5217

SENATOR GRAMS

Mr. Chairman, it is my distinct privilege to introduce to you today Mr. Mark Furth, chief executive officer and general manager of Associated Milk Producers Incorporated, or AMPI, a 5000 member dairy cooperative based in New Ulm, Minnesota. AMPI annually markets 5 billion pounds of milk for dairy producers from Minnesota, Wisconsin, Iowa, Nebraska, Missouri, South Dakota and North Dakota and operates 13 manufacturing plants.

Mark has been with AMPI for 30 years, beginning as an accountant and became general manager in 1990. Mark has also previously served on the board of directors for the National Milk Producers Federation and the Minnesota Dairy Leaders Roundtable.

I appreciate his willingness to come to Washington today to highlight the fundamental unfairness of our nation's dairy pricing system and to propose alternatives to the existing structure.

Mark has endured the same frustrations I have with Minnesota family farmers being forced out of business due to a system that helps producers in other regions of the country gain a competitive advantage over them. Again, I thank you for the opportunity to introduce Mr. Furth and know that his suggestions will be useful for the work of this committee

and the Senate.

OPENING STATEMENT OF TOM HARKIN
RANKING MEMBER
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
FEBRUARY 9, 2000
FEDERAL DAIRY POLICY

Thank you Mr. Chairman,

Yesterday we heard testimony pretty much across the spectrum on the status of our dairy industry, Milk Marketing Orders, and Dairy Compacts. I think it is pretty clear that we have a ways to go in finding a dairy policy that is equitable for all farmers nationwide. But, I do think I see the direction we need to head. We need a policy that adequately ensures adequate income to dairy farmers, while placing all dairy farmers on an equal footing.

It seems to me that the fight about the Dairy Compact and Milk Marketing Orders, at its heart, is about providing income stabilization to dairy farmers. Well, if we need to talk about income stabilization, let us do it at the National level. I don't think we get anywhere, in the long run, talking about just helping New England Farmers, or now South East farmers, while not addressing the status of the dairy industry nationwide. That will just perpetuate the bitter division we have today among regions.

And we do need to address this. We have the next iteration of the Farm Bill coming up in 2001. I am sure that dairy is likely to be an issue again during this year's appropriations process. And dairy farmers are currently struggling.

I hope today's panelists can help continue the discussion about what this century's dairy policy should look like. I would especially like to welcome Dennis Meyer, a dairy farmer who has traveled here from Bernard, Iowa to testify today. Welcome Dennis, and thank you, Mr. Chairman.