Testimony of

Robert Wellington

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Crisis On The Farm: The State of Competition and Prospects For
Sustainability In The Northeast Dairy Industry
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Testimony by Robert D. Wellington
Sr. Vice President, Agri-Mark Dairy Cooperative

Time is running out for many dairy farmers and for much of the dairy industry if nothing is done to improve farm milk prices so I will get right to the point.

Prospects for sustainability in the Northeast dairy industry are falling rapidly due to the severe financial crisis faced by dairy farm families in the Northeast and throughout the nation. If a farm can not cover its costs and return a fair return for the investment and labor of its owners than all other aspects of sustainability become irrelevant. If farmers are not buying the inputs needed to run their operations and their milk is not flowing to processing and manufacturing plants, then the other nonfarm parts of the Northeast dairy industry also can not be sustained.

It has been estimated that each cow grazing on a hillside generates more than $13,000 of economic activity. This means that an average size farm in the Northeast milking about 100 cows results in over $1.3 million of economic activity. It has also been estimated that every 9 cows support one job in the dairy economy (from the farm inputs to the farm itself to the use of the milk and other products from the farm). If that average family farm is forced out of business, $1.3 million of economic activity and eleven jobs go with it.

This past January a number of dairy industry representatives went to Washington to warn legislators of the crisis looming on the horizon. The Vermont delegation listened and understood but other areas of the country remained in denial. When we explained that an industry supporting over a million jobs and far over $100 billion dollars in economic activity was at risk due in great part to the national and worldwide recessions, Congress and the Administration still refused to provide any relieve for the dairy farming community in either the Stimulus Package or the supplemental appropriations bill despite support for that relief from the entire Vermont delegation and others.

Now the situation has hit home and dairy farmers are facing the worst financial situation since the great depression. They are receiving 1979 milk prices but paying 2009 production costs. The result is thousands of dollars of losses per month on small farms up to hundreds of thousands of dollars losses per month or more on larger multi-family farms.

The following chart was put together by Dr. Mark Stephenson of Cornell. It shows a milk cost index versus a milk price index for the past twenty years. The situation has progressively gotten worse and is the most severe in 2009.

The causes of farm milk price volatility are many but a primary one is the misalignment of supply and demand for milk and dairy products. It has been shown all too often that a mere two or three percent misalignment can move prices tenfold, that is, twenty to thirty percent. This is a terrible problem when prices are moving down but a wonderful opportunity on the upside!

The immediate problem today is cash on the farm. Either market prices need to rise dramatically immediately or else another source of money needs to reach the farm. A doubling of the MILC payment levels as well as increasing the cap retroactive to February 2009 would be extremely helpful for most farms in the Northeast. Measures to enhance market prices like the $350 million additional price support allocation in the 2009/2010 agriculture appropriation could be even more helpful if used appropriately.

One of my major concerns is that cheese prices were below the support price for much of this year as it was this week, but no product was removed from the marketplace. This was the worst of both worlds.

The support price created a benchmark price to depress market prices but it never resulted in any surplus product being removed from the marketplace. That cheese surplus is sitting in private warehouses and is a major factor why cheese prices are far less likely to recover very much this autumn. USDA needs to actually buy product to balance supply and demand!

Market prices will eventually recover as more producers leave and milk supplies tighten but this is a long, painful and terrible process. Low prices have gone on much longer and gotten much lower than anyone had foreseen a year ago and now it may take until well into 2010 before acceptable price levels are reached. However even once milk prices recover it will take a long time for farmers to repay the debt accumulated and equity lost in just the past nine months. The one certainty appears to be that prices will likely fall back to the pattern shown in the above table in 2011 or 2012 if nothing is done. We are looking at alternative long term pricing and programs to reduce volatility and low net income levels. The problems are many and include reaching a consensus among many strongly opinionated dairy farmers.

Farmers have funded a supply/demand management endeavor know as CWT (Cooperatives Working Together) for several years. It works well when small surplus' developed but has yet to fully impact the current dairy crisis despite conducting three herd buyouts this year. This is a voluntary programs funded by dairy farmers producing about 70% of the milk in the country. However non-participants, often called free-riders, gain the same benefits without paying a 10-cent assessment.

Some cooperatives would like to see a mandatory, government authorized CWT program. While that could eliminate free riders, it would also result in other problems that must be addressed. Some people would use the futures markets to address the price volatility problem. While that could work, it would not necessarily improve farm income over time and could depress it. The following chart for the years 2000 through 2004 (also prepared by Dr. Stephenson) shows the average futures contract value over the period versus the actual Class III final price for each month. Volatility was reduced, but the average contract price received was less than when using no contracts.

Some people have suggested using some type of farm revenue insurance. While this might help, one must keep in mind that insurance premiums are usually affordable because the event that one is insuring against is rare. If one out of every 1000 houses burns down each year, the premium rate can be low. However if every house burned down every three years, the premiums would be huge and likely unaffordable. Milk prices have been burning down every three years for all dairy farmers!

Supply control programs such as those proposed by the National Holstein Association have merit but only if dairy farmers are agreeable to the restrictions set therein. Whatever plan that is brought to Congress must enjoy an overwhelming consensus of dairy farmers if it hopes to have a chance of passage in my opinion.

We do not to find the right method to send the appropriate signals to dairy farmers when too much milk is going to severely depress milk prices. Farmers are going to do what is best for their operation and their family and rightfully so. However when milk prices rise, farmers often increase production to capture more revenue and hopefully profit but then when milk prices fall, farmers often increase production to maintain cash flow and minimize losses. Farmers' reaction when prices fall is bad for market prices but appropriate for the farm operation. Farmers must be told when marginal, additional milk has less value and given an incentive not to produce it.

For example, the U.S. produces about 190 billion pounds of milk. At $12 per cwt., that milk is worth $22.8 billion. If U.S. farmers produced 5% less or $180.5 billion pounds, it is estimated that their milk price could be $18 per cwt. That price would produce $32.5 billion dollars even through less milk was sold. If you took the revenue difference ($22.8 billion less $32.5 billion or -$9.7 billion) and divided it by the extra milk produced (190 billion pounds less $180.5 billion pound or 9.5 billion pounds), you would get a value of -$102 for each surplus cwt produced. If farmer income was reduced by $102 per cwt (which is effectively what has happened in the past year) for that 5% of their production, I am sure they would find a way not to produce or market it.

Finally Federal order pricing reform is needed to raise Class I differentials and floor those prices. Volatility in cheese markets should not have to produce volatility in fresh drinking milk markets. Thank you for the opportunity to address these issues and for all the help you have provided dairy farmers over the years. I would be happy to provide further details or thoughts as needed.