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# REVIEW THE STATE OF THE UPPER MIDWEST DAIRY INDUSTRY

A FORUM

before the

SUBCOMMITTEE ON DEPARTMENT OPERATIONS, OVERSIGHT, DAIRY, NUTRITION, AND FORESTY

of the

COMMITTEE ON AGRICULTURE

U.S. HOUSE OF REPRESENTATIVES

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# PUBLIC FORUM TO REVIEW THE STATE OF THE UPPER MIDWEST DAIRY INDUSTRY

**WEDNESDAY, MAY 31, 2006**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
OVERSIGHT, DAIRY, NUTRITION AND FORESTRY,
COMMITTEE ON AGRICULTURE,
*Winona, MN.*

The subcommittee met, pursuant to call, at 9:57 a.m., Kryzsko Commons and College Center, Winona State University, 175 West Mark Street, Winona, MN, Hon. Gil Gutknecht (chairman of the subcommittee) presiding.

Mr. GUTKNECHT. If I could get everybody to take a seat. As some of you know, that I am also licensed and bonded auctioneer. And one of the things they teach you in auction college is to start on time, and so it is 10 o'clock. And there probably will be people coming in and leaving throughout the meeting.

But before we really get started, I want to thank Dr. Judith Ramaley. Dr. Ramaley is the president of the Winona State University. And the interesting irony of this, as many of you may know, I also serve on the House Science Committee. In fact, now I'm the vice chairman of the House Science Committee. And Dr. Ramaley used to come up and testify very, very regularly, so I have actually been working with Dr. Ramaley for probably at least 10 years. So she wanted to at least extend a welcome. And, Judith, do you want to come up here.

Ms. RAMALEY. Sure.

Mr. GUTKNECHT. I'll even give you the mic, here.

Ms. RAMALEY. Congressman, it's good to be back in a hearing room with you. It's a familiar feeling. The congressman was one of the people in those hearings with the Science Committee who actually was paying attention. Most of your colleagues were busily preparing for the next event, and you were one of the few people I ever noticed that actually was listening, so I think I can guarantee that today he will listen to this very important information.

Winona State has, for a number of years, been very serious about its relationship with the community. And we have, in the last couple of years, accelerated our interest in economic and community development. And I'm particularly grateful to be here today, because my most recent presidential post was in Vermont.

Now, you all know that Vermont is particularly known for its dairy industry. And any of you who like ice cream have probably figured out that all they have are Holsteins, which is, by the way, not true. They have other cows. But Ben & Jerry's only uses Holsteins. And so I had been in Vermont about a month when I went to the first county fair. Met up with the commissioner of agriculture, who proceeded to fill my head with statistics. And he told me how many cows they were losing in Vermont, so I looked up to see. And in Minnesota we've lost 166,000 dairy cows in the past 10 years. The decrease is a result in the loss of $235 million worth of economic activity, and that sounded just like Vermont, which is comparable.

So then we went to the cow barn where all the 4–H kids were showing off their prize cows, and I had a cow identification lesson from the commissioner of agriculture. And, now, those of you who are in the dairy industry know that cow barns are noisy. And so I'm standing there with the Commissioner of Agriculture, and I'm saying to him, "How do you greet a cow?" You know, dogs you scratch their ears, cats you rub their bellies, what do you do with a cow? And he says, "By artificial insemination." And I said, "Mr. Commissioner, I said greet, not breed."

With that, I turn things back to the Congressman.

Mr. GUTKNECHT.1 We thank you for that welcome, Dr. Ramaley. And she's entirely too modest.

I need to mention one other thing about this beautiful campus, and this is one of my favorite campuses. You can just see what a wonderful place and what a great job they do of taking care of it. But one other point she didn't mention. This is the home of the NCAA Division II basketball champs, and we were all incredibly proud watching the team. In their last, what, 20 games in a row they've won, and they did it in spite of some amazing obstacles along the way, including a fractured leg with their point guard. So it's a great story.

And my congratulations to all the folks here in Winona on that great championship.

Let me just begin with a few comments about my view of this issue and the way we do business in my office and on my subcommittee. Let me just talk a little bit about the subcommittee. It is, I'll brag a bit, it is the most powerful subcommittee on the House Agriculture Committee, because, No. 1, we have oversight over the entire Department. And it is kind of nice when the Secretary is going to come up and testify before the full House Agriculture Committee, very often they will call me first and go through the testimony they're going to give and essentially say, "Does that sound all right to you?" And that's kind of nice to have that happen.

Many people don't know, the Department of Agriculture is the second largest department in the Federal Government, and what we do is incredibly important for a whole variety of reasons. Also on our department oversight, we have responsibility for the oversight of the national forests. And, again, this surprises people that the national forests are under the purview of the Department of Agriculture, and I always tell people there's a reason for that. Many years ago it was determined that trees are crops, and the Department of Agriculture should have something to say about how those crops are managed. And at another hearing, perhaps, I'll talk about that.

We also have responsibility for all of the nutrition programs. And we in the United States had decided a long time ago that no American should ever go to bed hungry, and so this year we will spend about 40 billion of your taxpayer dollars making certain that no American goes to bed hungry. And we think that's important.

We also have responsibility for the oversight of the renewable energy programs. And I think that's one of the most exciting things that's happening, not only in the United States, but especially here in Minnesota, and particularly related to value-added agriculture as it relates to ethanol and biodiesel and biomass and the other things that we can produce. I believe strongly that renewable energy is going to play a very important role in making us more energy independent.

In fact, to that end, the subcommittee had a hearing last Monday in Detroit, Michigan, and we invited some of the leadership of the big three automakers. Well, I shouldn't say big three. We had DaimlerChrysler, we had Ford, and GM. We also had Volkswagen came and testified. And let me just assure you that they take renewable energy very seriously, and, frankly, they essentially gave an endorsement to my plan to increase the amount of renewable energy in the gasoline supply to 10 percent within the next decade.

Finally, our subcommittee has responsibility for oversight for the dairy programs. And of all the issues we deal with in agriculture, dairy can be sometimes the most vexing, partly because since 1834 we've had a bifurcated, if you will, some might even call it a balkanized dairy policy.

The Federal Milk Marketing Order system, I understand there are only three people in the Federal Government who completely understand how it works, and, therefore, they can't be on the same plane at the same time. But for regional differences, for a lot of other differences, dairy tends to be incredibly divisive. In fact, the time that I've been in Congress when we passed a farm bill, usually the very last item that's settled in the conference committee is the dairy title, and there's a reason for that.

The other thing I wanted to mention at the beginning of this hearing is that we practice in my office and on my subcommittee a fairly simple management model, and it is this. "Listen, learn, help, and lead." And we are currently in the first phase of that. We are listening and we are learning. And we have had hearings around the country, and I've been involved in meetings—first of all, earlier this year—it was this year, wasn't it, Ben? We went to New Mexico and saw some pretty amazing things down there. It was eye-opening for me to see how large and how quickly the dairy industry is growing in New Mexico.

Then we also had a meeting in Saint Paul, and some of you were at that meeting. And at that meeting we had some experts from New Zealand to talk about what's going on, including the Ambassador from New Zealand, to talk about what's happening with the dairy programs and dairy policy and dairy economics on that little island. Well, actually, two islands that make up New Zealand.

So we're going to have more hearings like this, and we're going to be listening and learning. But at some point we're going to have to leave. And if I have anything to say about it, we will be at the table when the agriculture, the next farm bill is put together. And

I'm a strong believer in value-added agriculture. I'm an even stronger believer that dairy is, perhaps, one of the most important, and, in fact, I would say the most important form of value-added agriculture. And it's no coincidence that we're here in Winona, because the people here in Winona really do understand how important dairy and value-added agriculture are, and we're going to be recognizing a few folks at noon for what they do.

We've had field hearings of the full committee in North Carolina, in Alabama, in California. I'm trying to remember where the other places are. And we'll have more hearings, because we want to hear from real producers. But as I drove down here—I'll finally just conclude by saying this. As I drove down here, I think all of you must have had the same experience, and that is what a beautiful part of the country this is, and how blessed we are.

Really, for every reason that I can imagine, this is the dairy center of North America.

And I want to make certain that we adopt policies at the Federal level that allow and encourage that to continue. We have the water. We have the resources. We can grow the alfalfa and the corn silage. We don't grow cotton seeds, but that's relatively cheap to buy from Texas, but just about everything else. We have the herdsmen. We have hardworking people. We have the infrastructure. We have the cheese plants. We have everything we need here, except sometimes Government policy. And so to that end, it's not a coincidence that we're here in Winona, Minnesota.

With that, I've probably spoken longer than I'm supposed to. I would like to welcome our first panel of witnesses, and we are delighted. We have assembled today some experts, not only from Washington, but locally about the dairy industry, and hopefully have some very interesting observations about where we've been, where we are, and hopefully where we will go. I would like to invite our first panel.

First we have Mr. Lloyd Day, who is the Administrator of the Agricultural Marketing Service of the U.S. Department of Agriculture. He's accompanied by Paul Kyburz, who is the Market Administrator for the Upper Midwest Milk Marketing Area, and Dr. Bob Cropp, who is well known to many of the folks in this room. He is a professor emeritus of the Agricultural and Applied Economics Department at the University of Wisconsin at Madison. And I would first go to Mr. Day, and, again, welcome and thank you for coming to beautiful southern Minnesota.

**STATEMENT OF LLOYD DAY, ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY H. PAUL KYBURZ, MARKET ADMINISTRATOR, UPPER MIDWEST MILK MARKETING AREA, MINNEAPOLIS, MN**

Mr. DAY. Mr. Chairman, good morning, and thank you for the invitation to appear before the subcommittee today and in this beautiful part of the country. It's my first visit here, and I must say, it is beautiful, and the weather is certainly better than Washington, DC today. My remarks will briefly highlight the general economic conditions facing U.S. agriculture, and then focus on the dairy industry here in the upper Midwest.

The general economy continues to be strong with growth rates in 2006 expected to be similar to 2005, but below 2004. Increased energy costs, rising interest rates, and high consumer debt loads are expected to result in slower, but still strong, domestic expenditures on food. U.S. exports, including agriculture products, are expected to grow with the decline in the value of the dollar. On May 9 the Department of Energy projected the 2006 diesel and national gas prices will increase by 12 and 7 percent respectively, over the 2005 increases of 33 and 19 percent respectively. The costs of fertilizer, planting, harvesting, and drying will increase and add about 5 cents per bushel to the cost of growing corn in 2006.

The dairy industry nationally has had 2 years of strong prices. Milk production continues to increase in response to near record milk prices in 2004 and 2005, restored availability of rBst, and improved forage conditions. Milk production is forecast to be up nearly 3 percent in 2006, following a 3.3 percent increase in 2005. The production growth is coming primarily from the Western States on larger herds; as the number of dairy operators continues to decline nationally. This growth in production continues to exceed dairy product demand. USDA's May forecast estimated the all-milk price to average between $12.35 and $12.85 per hundredweight in 2006, down 15 percent from 2005.

Dairy production costs are expected to be higher in 2006 than in 2005, primarily due to increased energy and feed costs. Corn is expected to average about $2.40 per bushel, 40 cents higher per bushel over last year. While soybean prices are expected to be $170 per ton, as compared to $175 in 2005.

USDA forecasts the 2007 milk production growth to be less than 1 percent, with farmers responding to higher feed costs and lower milk prices in 2006. The 2007 all-milk price is forecast to increase an average of between $12.85 and $13.85, up 6 percent over 2006, as the result of lower production growth, coupled with a higher growth rate in demand.

The Commodity Credit Corporation is currently purchasing nonfat dry milk from Western States. The USDA estimates net removals of about 110 million pounds in 2006 and 195 million pounds in 2007.

The Milk Income Loss Contract Program was extended for 2 years, through August 2007, by the Deficit Control Act of 2005. The MILC Program was originally authorized in 2002 and generated over $2 billion in direct payments to producers for fiscal year 2002 through fiscal year 2005 production.

In the United States, milk benefited in 2005 from tight world supplies of dairy products and a relatively weak U.S. dollar. Reduced milk production in New Zealand, Australia, and the European Union limited supplies available for export, and coupled with robust demand, 2005 international nonfat dry milk prices averaged 10 to 15 percent above 2004 levels. With world prices above the price support rate, the United States significantly increased exports of commercial milk powders. On the import side, lower U.S. butter and cheese prices resulted in import reductions of butter and American-type cheese compared to 2004. Similar trade conditions are shaping up for 2006. Global demand for dairy products remains firm, the U.S. dollar continues to be weak, and U.S. skim milk powder prices are expected to be competitive.

Wisconsin and Minnesota milk production in 2005 was 31.1 billion pounds, about 18 percent of the 177 billion pounds of U.S. production. In the two States, 1.7 million cows represented 19 percent of the U.S. dairy herd of 9 million cows. In 1995, Wisconsin and Minnesota milk production was 32.4 billion pounds, about 21 percent of the U.S. milk production of 155.3 billion pounds. Wisconsin and Minnesota total milk production has fallen by about 4 percent since 1995, while U.S. production has increased by 14 percent.

Over one-quarter of the Nation's dairy operations are located in Minnesota and Wisconsin.

The Upper Midwest Federal Milk Marketing Order regulates the processors and manufacturers who purchase a major share of Minnesota and Wisconsin milk, along with some milk from North Dakota and South Dakota, Iowa, and Illinois. In 2005, 22.4 billion pounds of milk was pooled on the upper Midwest order, about 20 percent of the milk marketed through all ten Federal orders. Two-thirds of the upper Midwest milk was used in cheese, while about 20 percent was used for fluid milk products.

Cheese will continue to be the major use of milk in the upper Midwest. However, growth in western milk production and commodity cheese making capacity is shifting incentives for the upper Midwest towards artisan cheeses and other value-added forms of dairy product production. The Wisconsin Specialty Cheese Institute and the Wisconsin Dairy Business Innovation Center are helping the shift in that direction.

Finally, I would like to speak to you briefly about two programs of the Agricultural Marketing Service. The Federal Milk Marketing Order Program is one that continually changes to reflect relevant marketing conditions in the dairy industry. Several regulatory decisions are in various stages of completion that relate to the upper Midwest. These are the Fluid Milk Product Definition Recommended Decision affecting all 10 orders that was issued this last month. The issue of class III and class IV manufacturing allowance levels used to calculate the value of milk was heard at a national hearing in January of this year. And then there were several hearings held in the upper Midwest, Mideast, and Central orders to address pooling and re-pooling issues. Interim rules and recommended decisions have been issued. Recommended decisions were due April 24 for all three orders, and final decisions are being prepared.

The Federal order rulemaking process has received significant attention recently by all sectors of the industry regarding the length of time involved to complete regulatory actions. AMS undertook an extensive internal review of the process and has developed several new rulemaking initiatives and customer service standards. Our goal is to improve the timeliness and transparency, while at the same time maintaining the opportunity for public involvement that currently exists. Through this initiative, AMS expects to improve non-emergency rulemaking timeliness by reducing the time required to complete regulatory actions by over one-third.

AMS also oversees the operations of the National Dairy Promotion and Research Program and the National Fluid Milk Processor Promotion Program. As per capita consumption of fluid milk products continues to decline, these programs are proving to be very positive forces in the development of new markets for milk and dairy products. Among the most important is the effort to provide products that the consumers demand. One such effort, the promotion of the single-serve milk in plastic bottles for schools and restaurants is expected to add over a billion pounds of fluid milk sales.

Dairy Management, Inc. has become partners with several restaurant chains to increase their sales of fluid milk. Thus far, during the initial launch in 20,000 restaurants, combined weekly average milk sales have grown exponentially. And to put it in numbers, it's gone from about 600,000 units to over 2 million units in just one restaurant. More restaurants will have a national rollout of the single-serve containers in June.

In addition to milk, the National Dairy Promotion Program is partnering with a fast-food chain to test and market a 7-ounce strawberry yogurt cup that is now a permanent menu option. This introduction helped lead to a 7 million-pound increase in annual milk used through that food service.

In conclusion, although the U.S. dairy industry is experiencing a year of reduced prices after 2 years of all-milk prices averaging about $15.45 per hundredweight, prices are forecast to increase in 2007. Milk prices in the upper Midwest are moving with U.S. prices. The MILC Program has been extended and will provide payments to farmers up to the 2.4 million-pound production cap. The demand for milk continues to be strong domestically and for exports of skim milk powders. The upper Midwest dairy industry continues to be a major supplier of milk and dairy products to U.S. consumers and a major positive factor in the region's economy.

This concludes my statements, Mr. Chairman. I'd be pleased to respond to any questions.

Mr. GUTKNECHT. Thank you, Mr. Day.

We'll come back and ask you a couple questions, but first we'll go to Mr. Kyburz, and tell us what's happening in the Midwest.

Mr. KYBURZ. Well, good morning, Mr. Chairman. My name is Paul Kyburz, and as earlier mentioned, I'm the market administrator for the upper Midwest order, Federal Milk Order 30, which is one——

Mr. GUTKNECHT. So you're one of the people that actually understands how this formula works?

Mr. KYBURZ. Yes. I'm headquartered in Minneapolis. I'm the administrator for the upper Midwest order, which is one of 10 orders in the country, and the order which operates in this part of the country. I do not have a prepared statement this morning, but I'm here to accompany Mr. Day and to serve as a resource person on issues relating to the Federal orders, and particularly the upper Midwest order.

Mr. GUTKNECHT. Thank you, Mr. Kyburz.

Mr. DAY. He's here to answer the tough questions.

Mr. GUTKNECHT. That's why I've been here. In fact, there are probably a couple people I should introduce that are both here. And for those of you who don't know Ben Anderson, he is one of the sharpest administrators that a subcommittee chairman could have on the House Agriculture Committee. He's from Minnesota. He understands Minnesota agriculture, and I couldn't do what I do every day without people like Ben, and I want to thank him.

I also want to acknowledge Malachi McNeilus. For those of you who are from Minnesota, he does a marvelous job of keeping up to date on all the agricultural and a lot of the things we're working on, whether it's renewable fuel or wind energy, whatever, Malachi does a great job.

I also want to acknowledge a couple of very important people in my life. First of all, Steve Wenzel. I see him back there. Steve is, he's the State director of rural development here in Minnesota, and we've been working with him on just a number of projects. One of the things we did in the last farm bill that, really, a lot of people don't know is we put an awful lot of money into rural development, essentially to try and encourage more value-added agriculture. And if there's anybody who cares more about rural development in the United States than Steve Wenzel, I haven't met him.

I also want to acknowledge John Monson. I see John back there. Do you want to stand up, John. John's our State director of FSA, and, again, we are just so lucky to have people like John in that job. It's a tough job, but he administers most of the programs that you folks deal with on a regular basis. And he's got a great team, and I know that there are several of them that are here.

Finally, one other person I want to acknowledge is State Senator Bob Kierlin. Bob, do you want to stand up. Bob has been a good friend and an incredibly good public servant for the people here in the Winona area. Unfortunately, he has so much talent and so much ability that he's going to apply it to different tasks, and he's going to leave the State Senate at the end of his term. And, Bob, I want to thank you publicly for your service to the people here in this part of the world in the State Senate, and I want to thank you for coming, because I think it demonstrates, even though you're a lame duck right now, you're still interested in issues that affect the folks in this part of the world, so thank you for coming.

With that, I'd go to Dr. Bob Cropp. As I say, no stranger to most of the people in this room. One of the distinguished experts on dairy economics at the University of Wisconsin. And we just want to thank you so much for joining us today, Dr. Cropp.

**STATEMENT OF ROBERT A. CROPP, PROFESSOR EMERITUS, AGRICULTURAL AND APPLIED ECONOMICS DEPARTMENT, UNIVERSITY OF WISCONSIN-MADISON, MADISON, WI**

Mr. CROPP. Thank you, Mr. Chairman, for the opportunity to talk about the upper Midwest dairy industry. I have testimony written out, and I won't spend the whole record, but I'll highlight some of the tables in there. I don't have to repeat all of it.

But somebody asked me how long I've been working with this stuff, and I said this is my 40th year at the University messing around with dairy and whatever, but it's a long time.

Commenting on the upper Midwest dairy industry, it's undergoing a lot of change, not unlike what's going on with the industry as a whole. And that's going on both at the farm level structure and at the plant level. And I think it's important to examine the structure of our dairy farms, and that will reflect somewhat what's going to happen down the road and reflect that policy.

Now, I'm using the time period, a 10-year period of 1996 through 2005, and mainly looking at three States; Iowa, Minnesota and Wisconsin. All three of those States have relatively small dairy herds. If you look at those three States in table 1, 10 to 20 percent of the herds have less than 30 milk cows. We have another 22 to 37 percent between 30 and 49 milk cows. About a third are 50 to 99 cows. We just have 10 to 16 percent that have 100 to 199 cows, and 1 to 5 percent, 200 plus. And this comes from USDA dairy farm structure.

During this past 10-year period, all size groups experienced substantial declines, and of those smaller groups, 50 to 60 percent decline in 10 years. The 200 plus herds, however, experienced increases in farm numbers. The 200 plus herds, that's a fair amount of increase in Minnesota of 77 percent, 157 percent increase in Wisconsin. The total number of herds, of course, during this 10-year period declined 45 percent, and that's a little bit more than the national decline of about 40 percent. Yet, after that kind of change, the average herd size is still only 80 cows in the upper Midwest, compared to about 115 nationally.

Table 2 breaks down the production a little bit finer, and also shows the percent of milk that's produced by each farm structure. In Iowa they have 1.2 percent of the herds that have 500 or more cows, but that 1.2 percent counts for 21 percent of the milk. In Minnesota that size group represents about 1 percent, but almost 15 percent of the milk.

And for Wisconsin, 1.3 percent of the herds' 500 plus cows, 16 percent. This compared to U.S., about 3.9 percent of the herds over 500 cows, with 49.5 percent of the milk. If you drop it down to 200 plus cows in the upper Midwest, that's still only 5 percent of the herds, but about a third of the milk is produced by herds over 200 cows. This compared to 10 percent of the herds in the United States of that size producing 65 percent of the milk.

Table 3 shows what has happened to milk cow numbers in the upper Midwest as compared to U.S. The decline in cow numbers, of course, is less than the decline in the number of farms, reflecting the growth of the size of the herds. But during this 10-year period, both Iowa and Minnesota experienced decline of cow numbers of more than 22 percent, compared to about a 15 percent decline in Wisconsin, and only 3.5 percent in the United States.

Table 4 shows the total milk production in the upper Midwest compared to U.S. in this 10-year period. During this 10-year time period, Iowa and Wisconsin had a small increase in total production, 5.1 to 2.3 percent respectively. However, Minnesota experienced a 13.2 percent decline in milk production. The Nation's milk production increased 14.9 percent during this period. The decline in milk production for Iowa and Wisconsin appears to have ceased somewhat with new dairy farm investments starting to produce a slow increase in milk production.

In fact, Mr. Day indicated, I think, Wisconsin started to experience an increase in cow numbers during 2005, and that hasn't occurred for about 20 years, and had a 3.5 percent increase in milk production. Iowa had a 4.4 percent increase in production, there's a few more cows and stronger production per cow. Even Minnesota had a 3.4 percent increase, even though their cow numbers were down about 1 percent, but a 2.2 percent increase in production per cow.

What's going on is that dairy development initiatives in Iowa appear to have a positive impact, bringing about a change in the dairy industry. The Wisconsin State legislature has been very positive for dairy development; including funds for dairy expansion planning, investment tax credit, low interest loans for adding cows, funds to support grazing, and a recent citing legislation that will greatly improve the process for dairy farmers wanting to expand their dairy operations. The State of Minnesota has been made aware of and is trying to pass a similar type of legislation. It's in the process right now.

The lack of a growing milk supply in the upper Midwest has led to a very strong competition between dairy cooperatives and other milk processors for milk to fill their processing plants and to meet consumer needs for cheese and other dairy products.

The upper Midwest dairy cooperatives and other milk processors pay dairy farmer substantial premiums above regulated Federal Milk Order minimums. Similar premiums are not paid by milk processors to dairy farmers in the growing milk production regions of the West. Further, California is not part of the Federal Milk Marketing Order system.

The State milk pricing system sets minimum dairy producer prices for milk going into butter, milk powder, and cheese below that of Federal Milk Marketing Order minimum prices. The result is mailbox prices paid by dairy cooperatives and other milk processors to upper Midwest dairy producers more than a dollar per hundredweight higher than what is paid in California and other Western States. While these higher mailbox prices are beneficial to upper Midwest dairy producers, these higher premiums are not sustainable in the long run. This difference in milk cost to upper Midwest cheese plants makes it difficult for them to compete pricewise against California and other western cheese plants in marketing cheese to a competitive national market.

The upper Midwest dairy cooperatives and other milk processors need to generate sufficient net plant margins for capital investment in plant and equipment if they wish to maintain modern and more efficient processing technology required to be competitive with the new and larger processing plants recently built and being built in the West.

The chart below shows the average mailbox prices for selected States in the last 2 years. You'll see substantial differences between the West and the upper Midwest, and even very competitive in the North, Northeast.

The competitiveness of the national cheese market and tight margins has forced consolidations of cheese and other manufacturing milk plants in the upper Midwest. Any major new cheese plant has not been constructed in more than 18 years, in Wisconsin, that is.

Table 4 shows the change in the upper Midwest cheese plants during the 10-year period. The number of cheese plants declined by 18 percent in Wisconsin, 31 percent in Minnesota, no change in

Iowa. This compared to only a half percent decline of cheese plants in the United States.

With the upper Midwest dairy industry characterized by more than 40 percent of their dairy herds having fewer than 50 cows, they will continue to experience a rather rapid decline in dairy farm numbers. Most of these smaller herds have outdated facilities in need of repair and updating, and are operated by older farmers who will be retiring. In most instances, these small dairies are not large enough to support an adequate family living. Yet, the upper Midwest will continue to have a relatively large number of small dairy farms that can be profitable and sustainable. These are dairy farms that have adopted to low inputs through grazing or producing milk for growing niche markets such as organic or BsT free milk. Make note here that the organic plants are paying $22 per hundredweight minimum price right now for milk. That's their minimum price for the year.

Some are hooked up with supplying smaller cheese plants that are making higher margin specialty cheeses. In fact, the specialty cheese business that grew 7 percent in Wisconsin last year now accounts for 15 percent of the cheese production in Wisconsin. It's their high number products. And others have entered into on-farm production and sales of beverage milk, cheese, yogurt, some are successful at that. These examples are fine for those who wish to remain small and have the associated lifestyle, but they will continue to account for a relatively small share of the U.S. total milk production.

But, if the upper Midwest is to slow or to stop the decline in the number of milk cows and total production, there needs to be more larger herds, 500 to 1,000 cows, and even larger dairy operations. Wisconsin's recently implemented citing rules to help make this possible. But, also, the number of dairy farms in this 50 to 90 cow range need to modernize and to grow their dairy operation to a size that will support two or more families. This is because 40 percent of the upper Midwest herds are in this 50 to 90 cow size and account for about a third of the total milk production. Without this type of herd expansion, it may not be possible to offset the exiting of smaller herds, and to grow, let alone maintain, its dairy industry entirely from additional 1,000 plus cow herds.

There are a number of these 50 to 90 cow farms that have already expanded, modernized, and now serve as models for others to follow. Many have used the old dairy facility to put in a low-cost labor-saving milking parlor and built a free-stall barn for better cow comfort and reduced labor time to feed and care for the cows. Many of these have expanded their herds to 125 to 250 or more cows. Cost data shows that these farms can be very competitive with larger cow operations from a per hundredweight cost of milk production comparison. And maybe even more important, they provide a favorable lifestyle that allows families to have some free time, to take a vacation, and engage in more family activities and the like. Planning grants, investment tax credit, low interest rate loans to add cows previously mentioned are examples of programs in Wisconsin that are assisting the dairy farmers to expand and modernize.

The upper Midwest, as indicated, has the land resources, the climate, and existing infrastructure and market access for a competitive and profitable dairying. But, it needs to recognize that the dairy industry is a national market for milk and dairy products, and it's becoming more international. The upper Midwest dairy farmers, cheese plants, and other milk processors need to compete with the best in this national market, and yet be profitable. This requires the dairy herd modernization and expansion as mentioned. State programs, as described, can help foster this needed adjustment. But, since milk and dairy product prices are determined by national and international market factors, there is a need for effective Federal dairy policy. Dairy farmers often take on substantial debt when they modernize and expand. If upon completion of a modernization project, the dairy experience a long period of depressed milk prices, they can experience considerable financial stress and even financial failure. Federal dairy policy is needed to provide dairy farmers with a safety net for these low milk prices.

The existing Milk Income Loss Contract Program has provided an effective safety net to upper Midwest dairy farmers. The program is not perfect.

The $16.94 class I Boston price is well above market clearing levels the majority of the time. Thus, the program could be argued as price enhancement, rather than price risk protection, at least for those dairy farmers that have seen both payments under the program. And some argue, of course, that the 2.4 million annual payment discriminates against larger dairy farms and regions of the United States with mainly large herds. Yet, some type of program like this, a counter-cyclical program, could be very effective, providing dairy farmers with an appropriate safety net and at a reasonable Federal budget exposure level.

Some of our preliminary analysis we have done shows that a target price of manufacturing milk in the range of $10 to $11 per hundredweight would not be burdensome to the Federal budget and would provide a much more effective safety net to dairy farmers than this existing $9.80 support price.

That's a 3½ butter fat test, by itself. For one thing, $9.80 support price by itself is too low of a safety net to be much help to the dairy farmers, and it definitely is not a floor.

During the depressed milk prices of 2000, the class III milk price, milk used for cheese, was below support 7 of the 12 months and fell to as low as $8.57 in November. Then in 2002, the class III price was below support for 3 of the 12 months, in 2003 for 6 of the 12 months. Currently, the Support Program works fairly well for the CCC in purchasing nonfat dry milk during surplus milk periods, but it does not work very well for supporting cheese prices and, in turn, class III prices for several reasons.

There are proposals by USDA and the National Milk Producers Federation and others to make changes in the CCC Purchase Program to make it a better floor price. But, due to how the dairy industry now operates in the manufacture and marketing of cheese, I question if the proposed changes would correct the deficiencies of the CCC Purchase Program. Plus, the $9.80 price support program does not score very well under existing WTO rules, in fact, to argue, could be maintained in the long run.

So I would encourage Congress to consider in the 2007 farm bill, to give serious consideration to some type of counter-cyclical payment. Thank you.

Mr. GUTKNECHT. Thank you, Dr. Cropp. Insightful as always.

I don't really know where to start, but I do want to start with you, because, first, and before I say anything else, we want to work with you and others like you, because you mentioned at the end of your testimony the WTO, because that's one of the parameters. That's one of the things that is going to put pressure on us as we go forward with any kind of a farm program, and especially on dairy. What kind of pushback do you expect to see from some of our trading partners and competitors? Can you talk a little bit about that.

Mr. CROPP. OK. What's the——

Mr. GUTKNECHT. Pushback in terms of what we do, and how much are they going to push back as this market becomes more international.

Mr. CROPP. Oh. Well, I think from an international standpoint, we saw this last year, I think, an increase in international trading, which they probably reflect on it. And we actually increased on a total basis, and I think that's trade surplus, rather than to compensate. And part of it is due to what happened on the world market with New Zealand and Australia, the powder milk prices came up.

International market opportunities are going to be there. I don't see it as a major share of the industry. It's a very competitive thing. Because what happens at WTO, who knows how this final outcome is going to play out here, but it's going to be a long time to phase in, so our prices will be higher than the world market prices. We're competitive on whey, maybe. On nonfat dry milk, I think there's optimistic little sell there. When it comes to cheese, butter probably higher, but there's opportunity of growth there in some of the specialty cheeses.

I think we've got to recognize those international forces, but also the national markets here that some will argue we use the price support program as a safety net, that's totally not effective. To make it effective, you would have to increase the purchase prices of these products, which makes us less competitive on the international market. And even question then whether or not it would work effectively, based on how cheese is marketed today and a lot of prearranged sales by cheese processors and such.

So one advantage of having the target price program somewhere in that $10 to $11 range would not be, I don't think, burdensome to the Federal budget, simply because it takes about an average manufactured milk price around $12, an average whole milk price $13.50 to $13.75 to supply the milk we need for the market.

Even higher prices than average, which we saw in 2004–05, will lead to cow expansion. The lower prices, we had that long dry spell in 2000–03. Cow numbers went down. We went 2 years without any increase in production. International markets opened up. We cleaned out the cupboard for nonfat dry milk and had very nice prices, so there's a lot of volatility to the market. It's not out of line to pay too much or too little. So I think we need some kind of safety net, but I think we should allow the markets to work, both domestically and internationally.

Mr. GUTKNECHT. You also talked about, and I'm really interested in what you talked about with what's happening in terms of the States, and I'm not—we can't get into State policy that much, but you did indicate that there are things that the States can do. And I am concerned about the loss of cow numbers and milk production here in Minnesota and throughout the upper Midwest. Are there specific things we can do at the Federal level that would encourage more younger farmers to consider getting into the dairy industry, No. 1, and, No. 2, to encourage more of them to upgrade their facilities? And maybe a more specific question would be, if you had a grandson who was 22 years old, would you encourage him to go into the dairy business in the upper Midwest?

Mr. CROPP. Well, I would encourage it as much here as any place, because I think there's some real, real advantages if they came here. And, in fact, we've had farmers reallocate from California to Wisconsin. There's one in Brodhead, Wisconsin. He's got a herd in California, a herd in Illinois, and Wisconsin. He would pick Wisconsin. He'd like to have built another operation in Wisconsin now, with even more cows, but because of resistance by local townships, farmers, he didn't do so.

And the reason being is that with the type of climate we've got here, I mentioned the corn silage, OK. Yes, it rains, it affects the quality when it's well, but I think California lost most of their first crop made because it rained out there too, so we effect the weather thing, but it's a place that cows do very, very well. And the fact is that we're located pretty good from a marketing standpoint.

We've got the infrastructure here, we need the milk supply.

From a marketing standpoint, it's a nice location. Where out West they have to market, even though transportation cost is not prohibitive, but with increased energy it's more costly. But we're in a nice position to produce the milk, to process and manufacture it, so it's a good place.

Milk price-wise, most of our milk goes to manufacturing, but that's what's happening nationwide is that cheese counts for about 40 percent of the milk utilization. You're going to have very competitive pay prices here. I indicated you get in trouble when you say it, but our plants pay too much for milk up here, in a way, because of the competition, and it affects the bottom line. Recognizing that we have to look at a national market, and so premium structures come down.

So if you look at what's going on, even in the last 5 years, look at mailbox prices.

They're coming much closer together. Yes, the Southeast will be higher, because that's a high cost production area, not a growth area. It will be a little higher in the Northeast. But the differences in milk prices come closely together, simply because milk moves, dairy products move. It's a national market. And our prices will probably average, maybe 50 cents higher than it will in the West, simply because of our location of marketing and some other competitive advantages.

So the resources are here. It's a good place to produce the milk, a good place for cow environment, what have you, and that's why

I see, perhaps—we believe that's why State legislature is trying to foster some of this change. We should not be doing this if we didn't think we could be competitive. We have enough examples now. Look at cost production for farmers. We're as competitive here as they are the best in the West.

Mr. GUTKNECHT. Well, I tend to agree with you. I think there is a future for dairy in the upper Midwest, and I think if we pursue this on the right—it the right way. So you'd like to see—just to summarize what you've told us, you'd like to see some kind of counter-cyclical program. OK. You haven't been real specific about that, but——

Mr. CROPP. One reason I think we need a safety net is because, look at what the international factors do up there last year, very positive what happened in the international market if the price is higher, it's up. We can withstand probably about a 1.5 percent growth of production here, somewhere around there, based on what's happening on the demand. Well, it depends how well cows milk. If you go more than that, then we have prices that drop $3 per hundredweight. The less that goes to the other extreme, a lot of volatility.

I'm a firm believer in price risk management concepts the farmers could use to try to manage some of that, but since these prices are determined by national market conditions and international conditions and the sensitivity prices, I think we need some safety net. I indicated, farmers, when they make substantial financial investments, get that thing going a couple years and hit bad timing with low prices, it's very stressful, and we need some protection on that. So State programs, I think, would be very effective to help encourage some of this innovation and modernization where we need Federal.

What I like about a counter-cyclical payment is that it lets the markets work, and the farmers get the difference when the market it below that. We'd probably have to put some payment limitation on it, what have you, but it lets the markets work. Where the current Purchase Program has basically been a nonfat dry milk purchase program, and why not take powder and sell it to Government, that's pretty good. If we didn't have that, yes, right now probably more milk would be going into cheese. It might lower our cheese price in the long run. It may stimulate more innovation in milk protein, some of these things here.

So I'd make some arguments on Federal orders and price support programs, some provisions of those might interfere with innovation in the industry. That we'd be all better off in the long run, both, again, look at international markets and domestic markets.

Mr. GUTKNECHT. In a rare moment of candor, we were in California not—well, it was about a year-and-a-half ago, and I asked them, "Why don't you guys produce milk protein concentrate here". And they kind of looked at each other, and finally one said, "Well, if we can make powder and sell it back to you guys, and we're guaranteed a profit," and that is part of the problem. And I think we've got to figure out how we can encourage people to look at some of these new markets, because what I learned in New Zealand is—or what I learned from some of the folks in New Zealand,

and even from Ireland, they see a big world market out there for some of these new products that, you know——

Mr. CROPP. I was just going to say, you've got to—I mean, Federal budget deficit is a reality, what we're going to be able to spend. But I think with a lot of work with whatever comes from policies or are existing ourselves, if you even took this last 5 years and take a target price, that 10 to $11 range in manufacturing price, yes, it's higher than $9.90. It would be a much more effective safety net to farmers. And even in those cases, you may run up to $600 million even cost, most of the times less than that, because in any time period you're going to have to average about a $12 manufacturing milk price. And that's what it's going to be with the volatility we have, but it's not something that would be burdensome on the Federal budget, so.

Mr. GUTKNECHT. Thank you.

Mr. Day, I apologize, I've spent a lot of time with Mr. Cropp, but I want to come back to you. I would be remiss in my duties, because I hear a lot from dairy farmers about the Dairy Export Enhancement Program, and you alluded to exports. Can I get you to maybe say something about the DEEP Program and how we could make better use of it as we go forward.

Mr. DAY. Well, the DEEP Program isn't being used right now, because the prices have gone down so much that they don't need it, because they're competitive on the world market. I know it was used in the past to some degree. That was really run under the Foreign Agricultural Service.

I think there's a lot of forces, and Dr. Crop alluded to some of them, that's going to impact you and your colleagues as you look to write the new farm bill. You have the Federal budget situation, which is in a difficult state. You have the Doha Round. We're not exactly sure where that's going to go. But if it does have an ambitious outcome, there is going to be significant pressures on any kind of a program that would support exports, such as an export subsidy, or any kind of domestic support payment or safety net. And then you just have the general competition among the American agriculture for funds.

And with all that combined, you talk about New Zealand and Australia, and how they've become a real competitive force in the world. And you've been out there to see how a lot of them are very small dairy farmers, and working in a cooperative way to market their product in the international market. And I've been approached by several dairy industry specialists. Some of those five or six people like Dr. Cropp that understands what's going on. And they're very bullish about the Asian markets. They're very bullish about the United States being a producer that can sell milk products into that market with the growth of those products. Sure it's going to have some competitive edge being a little bit closer, but a lot of those firms are starting to invest here, and I think the New Mexico firm that you visited is one of those firms. And there's also a lot of European investment in the Ohio region, and you have a massive investment in the Texas region.

So I think there's a bullishness about the future of dairy in the United States, and also the prospects of international exports. And I'm not sure whether a payment like DEEP is going to stand the tests of our trading partners. Whereas just the general competitiveness of American agriculture and the ability to be flexible in the competitive market in this way, I think, is probably the direction things will go.

Mr. GUTKNECHT. Well, Mr. Day, you said it better than I do. I was somewhat surprised at the dairy industry, dairy farmers in places like New Zealand. Relatively small countries like New Zealand and Ireland are investing significant amounts in the United States, in agriculture and dairy programs and dairy production facilities and so forth here. And I sometimes wonder if maybe they have more confidence in our dairy industry than we do.

With that, though, I do want to dismiss you, and thank you all for coming today to testify. Hopefully you'll stick around, because you might find it instructive to listen to some of the other panels, so thank you very much.

I'll call up the second panel. We will have with us Dr. Dana Allen, who is—the title she wears is director of the Minnesota Milk Producers Association. She is from Eyota, Minnesota. Mr. Bruce Maas, who is the director for Associated Milk Producers, from Walnut Grove, Minnesota. Mr. John Vrieze, president of the Wisconsin Dairy Business Association, from Baldwin, Wisconsin. And Mr. Mark Clark, who's a delegate for Land O'Lakes, from just not too far from where we sit right now, in Rollingstone, Minnesota. So if you folks will all come up.

Let me first of all say I have known Dr. Dana Allen for a number of years now. She actually worked for us for awhile, and is an expert in her own right in many areas of dairy production, particularly in dairy nutrition. She now works with her dad and her brother on a significant dairy operation just outside of Eyota. When you drive down Interstate 90, you can see it from the car.

Dr. Allen, welcome.

## STATEMENT OF DANA ALLEN, DIRECTOR, MINNESOTA MILK PRODUCERS ASSOCIATION, EYOTA, MN

Ms. ALLEN. Thank you, Chairman Gutknecht. As you mentioned, I own and operate a dairy farm with my parents and my brother south of Eyota, which is just about 50 miles west of here, and I'm proud to say that I'm a fourth generation dairy producer.

In addition to operating a dairy, I also serve on the board of directors for the Minnesota Milk Producers Association, the voice of Minnesota's dairy industry. Minnesota Milk, as we are known, has a growing membership of over 1,800 dairy producer members. We combine dairy producer leadership with over 250 associate members, and as I said, we do consider ourselves the voice of Minnesota's dairy industry. Our strength comes from working together with industry partners to create more opportunity for dairy producers. We focus on educational programs, as well as mobilize grass roots efforts to help set policy that will help shape our future.

Again, I want to thank you for inviting us to testify and give you some of our thoughts from Minnesota Milk's perspective.

The southeast portion of Minnesota has a longstanding tradition of being a strong, progressive dairy area. Our terrain of rolling hillsides provides many opportunities for forage production and environmental sustainability. Dairy farming lends it hands to such opportunities.

Our 5,126 dairy farms have an average size of about 74 cows, one of the smallest averages in the country. While we can celebrate the fact that dairy producers in this part of the country have been able to make a living on fewer cows than our counterparts elsewhere, we must continue to get better, and that sometimes means increasing the pounds of milk produced, either by adding cows or increasing the pounds of milk per cow. It could also mean adding more value to our products, cutting costs of production per pound produced, or any combination of the above.

In addition, consumers continue to demand low cost, high quality food. Consolidation is occurring all around us. Look at the explosion in major food retailers such as Wal-Mart and Costco, and the current purchase of Albertson's by SuperValu. As producers, we are continuing to adjust to the changes in the retail food industry. This phenomenon continues to put pressure on the processing and production side of all industries, including dairy farming.

Coupled with that, we have a new generation of dairy producers, like myself, who do want free time. I have chosen dairy farming as my career, because I love to work with the animals. I know, a little bit sappy, but that's the truth. There is nothing better than helping to deliver a newborn heifer calf, or having the fourth highest milk production per cow in the State of Minnesota. But there are also business realities that much be faced. Consolidation is one reality. The need to hire additional labor is another. If not addressed, Minnesota's industry will be stagnant, and the incentive for young people to come back and farm will continue to decline.

I share this with you to give you a better understanding of the dairy producer's perspective. Every dairy producer's dream is to own and operate a profitable and success business, while enjoying a wholesome, balanced life.

Overall, Minnesota's dairy industry has been able to maintain itself the last several years, which is an improvement from previous decades. In fact, we've even had some signs of strengthening. It has started with the resolve of dairy producers in Minnesota. We've been able to communicate our message to leaders at all levels to create policies that encourage a healthy and vibrant industry.

In particular, we have faced many State issues—or focus on many State issues in the past years. Governor Tim Pawlenty, his administration, and several State legislators have played a major role and deserve our thanks. With their help, we have reduced the number of farm losses and steadied milk production. However, we still have a long ways to go.

As we continue to stabilize and potentially increase milk production in Minnesota, our cooperatives and other processors must also be looking at ways to increase production or processing capacity. They must look into adding more value to what we produce on the farm. The adaptation of new technologies and improvements in efficiencies are needed not only at the farm level, but also at the processor level.

Milk assembly costs from the farm to the plant are unacceptable. While they have made great strides over the recent years, our processors must continue to work together, much more than they are now, to bring about increased deficiencies in milk assembly. They also must be constantly reinvesting in processing procedures that add efficiencies to the system and value to our product. We will continue to work cooperatively with our processors to make these internal improvements in our industry.

There are a couple policies that I would like to touch on briefly while I have the microphone. One of them is that we would request a price safety net that works effectively within the market, as Dr. Cropp has just recently spoke about.

Our current system limits marketing innovation. Minnesota Milk believes a possible solution is to design a price support system that would work in combination with the counter-cyclical program, like the MILC Program.

In addition, environmental regulations in Minnesota are among the most stringent in the country. We are not complaining. In fact, we believe the responsibility of environmental protection should lie with the people who make a living off the land, and we openly accept that responsibility. But, we would like to have other States step up and follow through on enforcing the Clean Water Act, as it is related to livestock operations. Consistent administration of environmental regulations across the country is fair and responsible.

To help dairy producers across the country comply with the Clean Water Act, Congress enacted the Environmental Quality Incentives Program, EQIP, as it's known. It is one of the most valuable and reliable programs Congress has enacted. We ask that you continue funding at the current level or higher. Minnesota dairy producers understand the environmental rules, and have grown to look at EQIP as a vital element in providing assistance needed to enhance their stewardship practices. We appreciate the 75 percent cost share limit established in statute. Unfortunately, in Minnesota, the administrators will only allow 50 percent cost share of practices.

Minnesota's State conservationist, Bill Hunt, is doing a fine job administering many aspects of the various conservation programs. However, this is one area that we would like to see immediate administrative changes. Environmental improvements on the farms can be quite expensive; increasing the cost share percentage to a number higher than 50 percent would benefit those that Congress intended the program to benefit.

In closing, Minnesota Milk asks that Congress continue to have an eye for the future. As I mentioned at my onset, my generation is the future of the dairy industry. We must learn from challenges of the past to reform and enact policies that will help cultivate profitable dairy producers who continue to care for the environment and their community. I believe the items laid out in my testimony and the other distinguished panelists help direct this vision.

Chairman Gutknecht, on behalf of Minnesota's dairy producers, I thank you for the opportunity to share our thoughts and ideas.

Mr. GUTKNECHT. Thank you, Dana. That was wonderful.

Mr. Maas.

**STATEMENT OF BRUCE MAAS, DIRECTOR, ASSOCIATED MILK PRODUCERS, INC., WALNUT GROVE, MN**

Mr. MAAS. Chairman Gutknecht, I appreciate your invitation to present my views and those of the 4,000 dairy farmer members of Associated Milk Producers, Incorporated, AMPI. My name is Bruce Maas, and I am a dairy producer from Walnut Grove, Minnesota, and a member of the AMPI board of directors. In my 25 years of dairy, I've also held elective positions in various other dairy-related organizations.

Today I will share a brief snapshot of my perspective of the Midwest dairy industry. The picture has changed significantly in 25 years; fewer dairy producers, fewer cows, fewer manufacturing plants. This region has lost market share to our western counterparts. Though overall market share isn't growing, we're slowly reinvesting in the industry infrastructure.

A look at our own family farm, it reveals an image similar to many across our region.

My wife, Maydra, and I have added a parlor, a free-stall barn, and more cows. More important, our son, Jared, has joined the operation, and that's a sign that we are optimistic about the future of dairy in the Midwest.

Our milk is manufactured into dairy products and marketed through AMPI. Our cooperative has closed a small number of our plants in the past 25 years, but we have increased capacity in others to gain efficiencies.

As a producer, I'm willing to invest in my farm and dairy cooperative if there's an adequate dairy price safety net. Establishing that safety net is, in fact, AMPI's dairy policy priority for the 2007 farm bill. Let me share four ideas for crafting a strong safety net.

Number 1, increase the support price. The current $9.90 dairy support price is inadequate, unchanged since the 1980's.

Number 2, make it realistic. The USDA's Commodity Credit Corporation, CCC, must increase the milk price equivalent it's paying to remove dairy products from the open market. Because of increased manufacturing costs, the support program today gives dairy producers about a dollar less than Congress intended when enacting the support program.

Number 3, provide a counter-cyclical payment. AMPI and other members of the Midwest Dairy Coalition believe that MILC is needed to further strengthen the overall safety net. The Dairy Price Support Program alone is inadequate and results in much less than the intended $9.90 level. When combining the MILC Program with the Dairy Price Support Program, producers are supported on their first 2.4 million pounds of annual production.

And, No. 4, manage imports. The CCC shouldn't be buying the world's milk surplus. By closing trade loopholes, foreign dairy protein wouldn't enter the United States and displace domestically produced milk.

I believe a strong safety net should not result in high dairy prices, but it should prevent the collapse of milk prices to a level that can't financially sustain the operation of an average dairy farm.

As Midwest dairy producers, we don't expect special treatment. We do want a fair chance to have a level playing field with the rest of the dairy industry. Right now we don't have that.

The Midwest dairy industry is primarily a processing industry. AMPI and other dairy co-ops take raw milk and manufacture it into products like cheese, butter, and nonfat dry milk. This is an energy intensive process, and rising energy costs have left us handicapped.

AMPI is one of several cooperatives that requested the January 2006 Federal Milk Marketing Order hearing to review make allowances in the class III and class IV formulas. The formulas were set in 1998 with fixed costs, and do not allow for sharp increases in energy and other costs associated with manufacturing dairy products. As a result, the formulas place dairy product manufacturing cooperatives in financial peril and at a distinct competitive disadvantage to those that sell most of their milk into the fluid market.

Testimony presented at that January hearing overwhelmingly supported the need for emergency action on this issue. Increasing make allowances is crucial for the long-term economic health of the Midwest dairy industry, its co-ops, and their producers. With more than 85 percent of Midwest milk marketed through dairy cooperatives, this issue is critical. We're still awaiting word from the USDA about how it will deal with this emergency request: Please hurry.

As a producer and cooperative member, I fully understand the three points I've raised today are tightly interwoven. I hope today's committee hearing will engage policymakers and industry stakeholders in an open debate and discussion about the Midwest dairy industry, dairy price support structure, and the regional disadvantage through the Federal order make allowances. The challenge will be transforming today's words into ideas and action.

Mr. Chairman, I want to thank you for hosting this field hearing and allowing me to testify. I'll be happy to answer any questions you might have.

Mr. GUTKNECHT. Mr. Maas, thank you, and before I forget, I want to thank you and the AMPI board members for reopening that butter plant in New Ulm, Minnesota. For a whole lot of reasons, I was very concerned that, perhaps, that plant would not reopen, and I'm delighted that it is reopened. It has a huge economic impact throughout southern Minnesota, so I want to thank you and all the board members. Please share that with them, will you, please.

Mr. MAAS. I will do that.

Mr. GUTKNECHT. Thank you, Mr. Maas.

Next we'll turn to Mr. Vrieze. Welcome.

**STATEMENT OF JOHN VRIEZE, PRESIDENT, WISCONSIN DAIRY BUSINESS ASSOCIATION, BALDWIN, WI**

Mr. VRIEZE. Thanks for asking me.

I'll introduce myself quickly. My family and I have about a 13 or 1,400 cow dairy in Baldwin, Wisconsin, just 19 miles from your border. A friend of mine and I also own another dairy about 9 miles away in Elmwood, Wisconsin. It has around 15 or 1,600 cows, so total we have around 2,900 to 3,000 cows in central St. Croix County.

But I'm here today representing the Wisconsin Dairy Business Association. We're not a producer organization, we're an industry organization, in that half of our revenues and half of our members are producers, and the other half of the members and the other half of the revenue comes from the infrastructure that supports the lenders, the feed dealers, the processors. So we think we've got a really nice mix on the industry, and we think we have a little different perspective, maybe, on the milk industry than if we were just a producer organization or just a corporate organization.

You've got my prepared remarks, but I'd like to just give you some comments off the cuff. We believe that the Federal order system in place today is an unworkable system. We think it's been tweaked to death and still isn't working.

To Mr. Maas', remarks here about the emergency hearing in January still hasn't been implemented that they want. Processors are bleeding red right now, all the cheese plants here in the Midwest are.

With the new make allowance, it will further distance my milk being sold to fluid milk by about 30 cents a hundredweight. And we believe milk is milk, and milk ought to be marketed to its highest value, so we're advocating the elimination of the Federal Milk Marketing order system, or at least going down to one order system.

We think the Midwest can compete with the rest of the United States and, in fact, the world, but we think milk ought to be made where it can most economically be made, and then transported to the end user, and that's not happening now.

I'd like to make an analogy. It would be like the States of Wisconsin and Minnesota putting together a Federal citrus marketing order where we have the artificial board put up not to let Florida citrus come in our State, and somehow create a greenhouse industry to raise my oranges. That's as irrational as a system that we have in place today with the Federal Milk Marketing Orders. My milk, or the milk in the United States ought to be made here in the Midwest and flown to Florida. Citrus ought to be made in Florida and traveled back to the Midwest.

There shouldn't be marketing orders to limit where those products can be moved to.

The second one is a classified pricing system. We believe that milk should flow to its highest value. If Mr. Clark's company would like to buy that milk and put it in a bottle today, he ought to be able to do that. If Mr. Maas' company wants to buy that milk today and put it in butter, he ought to do that. There shouldn't be this four-class system on pricing. Here in the Midwest, most of my milk gets priced on class III.

Another analogy, in my long history in the dairy industry, I spent 16 years in the auction business where we travel coast to coast selling registered dairy cattle. We would bring a commodity, which is a dairy cow, into the auction ring. We would have a price setting system, which was a lively auction bidding amongst the farmers there. When that cow came in and we started bidding, we didn't stop the auction just before we slammed the gavel down to say, “Well, wait a minute, now. Mr. Farmer, are you going to use that cow for seed stock? Then you ought to pay this price. Or if you’re going to use it just for milk production, then maybe you can pay a less price. Or if you’re going to buy her for beef, then you can pay a lower price.” That’s what our classified system is doing today, the way we’ve got it.

The farmer, which is the end consumer in that situation, bought that animal, and let him decide what he wants to use that animal for, whether it’s seed stock or milk production or beef production. Why should some artificial agency tell him that he has to pay X amount more for that raw product, just because he has a different use in mind for it. So we think we should get rid of the classified system and let the market dictate where that raw milk goes to today.

We’ve also got a layer of bureaucracy. Mr. Kyburz was up here earlier representing milk marketing. And we’d rather see the industry hire him to figure out new innovative products and where in the world we ought to be marketing those products, instead of paper shuffling milk around the United States through these milk marketing orders.

We’ve also got a layer of bureaucracy, quite frankly, in our processors that do the same thing. Well, let me see once, if I can send a load of milk to Kentucky, and then on paper can I move eight more loads to Kentucky out of this milk marketing order and then we gain some kind of a value. I mean, I’ve tried to study the Federal Milk Marketing Order and the classified system. Not only do I find it really boring reading, but it’s really an irrational system that really discourages you about this business. It was put in place 60 to 70 years ago for good reasons at that time. Those reasons are no longer there. I believe, again, that here in the Midwest we can compete with anybody in the world, and that’s what we ought to do.

We started talking about the world trade organization and how they look at our price supports, and how that’s going to affect world trade. We think that money spent today would be better spent on letting us meet the environmental challenges that we have, as well as you talked earlier about the renewable energy things that are happening from the big three automakers.

For instance, if you took the other stuff that comes out of the back end of the cow that we’re talking about today and turn that into biogas, you would only have to get that from about 15 percent of the cows in the State of Wisconsin. We’d produce as many BTU’s of energy as all the ethanol plants in the State of Wisconsin today. If we took that biogas and turned it into natural gas, we can actually create somewhere between 10 and 15 percent of all the natural gas used in the State of Wisconsin today. You scrub the carbon dioxide and hydrogen sulfide out of the biogas and you have a natural gas. So we think it’s a great new market.

We all talked about anaerobic digestion to make electricity. There’s other markets out there besides electricity. If we think the price of unleaded gas is going to be a dollar for the rest of our lives, we shouldn’t even be wasting our time talking about renewable energy. If we believe that the price of gas is going to sustain where it is or even go higher, that would be a great way to divert the money into animal agriculture, and we have another value-added product, which we've all been talking about. But when we talk about value-added, we only talk about the milk product. We ought to be talking about the energy that can be created out of animal livestock as well.

We talked about, Mr. Day, I think it was, the cost of energy and how that's affecting the plants earlier today. Well, we have an economist that looks at our books and networks with other large dairies in the Midwest. He said first quarter costs this year are about 8 percent higher. And it's not the diesel fuel that went in the barrel to run the Skid Steers, it's every product that comes on our farms, and that's where the cost is. He expects second quarter costs to be about 12 percent higher than they were a year ago. Mostly related, that's when the fertilizer hits the books for most of us dairy farmers. So we're having the same problems as producers as the processors are having with this.

But, again, we need to get into a free market system, because the Federal Milk Marketing Orders have not flattened out the price of milk. If anything, right now, there's more disparity than there ever was, so we have some other suggestions on MILC.

We like the counter-cyclical program. We think it's less cost to the Federal Government.

We also need to encourage the California colleagues that we have to come into the Federal system, if there's one, or to get rid of their system all together. I believe with the amount of congressmen from that State, we would be crazy to look at only Vermont, and hold hands with them. I think we better be holding hands with the guys in California, because they've got a lot more votes in Congress.

They also produce most of the milk in the nation.

They've got three concerns that need to be met. One of them is, we talked about that class IV manufacturing rates has encouraged powder plant construction out there. Those plants really need to move out of making all powder. You've got the Davis family right here in Le Sueur, Minnesota, that's really doing neat and creative things by way of protein and so on. That's what they ought to be making innovative, and we wouldn't need to be importing New Zealand whey and concentrates. We could be doing it ourselves. So we've got to figure out how to morph those plants in California out of making those dry powders into some innovative products.

The second thing, there's some folks there that over the years have bought fluid quota in the State of California, the dairymen. Those are on those balance sheets out there. We need to figure out a way to morph those folks, because I've got friends that have a half-million dollars on their balance sheet at the bank because they bought fluid quota contracts the past years. We've got to figure out a way to get them out of that.

And the other things is, the California dairymen have a different amount of milk protein solids that they've got in their fluid milk. They think the taste of the milk is better. It actually uses more dairy products. I tend to agree with them. That's another concern they have.

So I think those are all things that we can come to a common ground with the guys in California, but, again, I think we, in the Midwest, because we export much more of our production than we use by our citizenry in these two States, look much more like the western dairymen than, let's say, that we do than the eastern dairymen. Although the size of our farms might look more like the eastern dairymen, our industry as a whole looks much more like the West. Thank you.

Mr. GUTKNECHT. Thank you, Mr. Vrieze.

Mr. Clark.

**STATEMENT OF MARK CLARK, DELEGATE, LAND O'LAKES, ROLLINGSTONE, MN**

Mr. CLARK. Hi. I'd like to express my appreciation for being invited here to speak. I live just a few miles up the road, right up in the hills, and my son and I milk about 370 cows near Rollingstone, Minnesota. I am a delegate in my dairy cooperative, which is Land O'Lakes. As a delegate, I'm elected by my neighbors to participate in the cooperative's governance system and represent their interests.

As upper Midwest producers, we face some challenges, and not all these challenges can be solved by the Federal Government. But I do want to outline the challenges that I see, because I think it's important for you to keep them in mind as you move forward with the policy initiatives in Washington, DC.

One of the most difficult problems we face is market volatility. In recent years, we've seen milk prices fluctuate over a wide range. Peaks are higher than they used to be, and valleys are frightening low. We do have some tools that can help producers survive this period of low milk prices.

The Dairy Support Program has been the foundation of our national dairy policy for decades, and it still plays an important role in providing a stabilizing influence when milk prices sink. But, frankly, a $9.90 support price is not an adequate safety net.

One of the most important things that has occurred since the passage of the last farm bill is that more producers are learning how to use a futures market to protect themselves from extreme price fluctuations.

Another component of the milk price safety net has been the Milk Income Loss Contract for the milk. While support for milk has been controversial, for upper Midwest producers it has generally been a positive program. To the extent that Congress may consider some kind of counter-cyclical payment as part of the dairy program, we certainly would urge the following three basic principles: It should not discriminate between producers based on size; it should not discriminate between producers based on geography; and it should not result in distorting market signals by encouraging production at a time when milk supply is excessive.

For many producers, an exciting development over the past few years has been the creation of the CWT Program, Cooperatives Working Together. CWT is a modest attempt by the industry to exercise some degree of self-help. Through a voluntary 5 cents per hundredweight contribution, producers, through our cooperatives, have tools for influencing market volatility.

CWT will not be able to control extreme milk price and volatility all by itself. But that's my real point. A $9.90 support price can't succeed by itself, and neither can risk management programs, and neither can MILC. As we look towards the new farm bill and the future of dairy policy, it seems likely that the solution will require a combination of approaches. There likely won't be a one-size-fits-all dairy program.

While price volatility is one of the most challenging problems that currently face producers, from a Midwest perspective, one of the least visible problems that's emerging is the change in the dairy marketplace. We are seeing other regions emerge as even more intense competitors in the market for manufactured dairy products. This will have a dramatic impact on our upper Midwest cheese industry.

Part of the solution is to adopt new policies at the State and local level that encourage the growth of milk production in the upper Midwest.

We have to redefine public attitudes about modern milk production practices, and focus on creation of jobs and economic development. We must find ways to add value to existing milk production. This will require new, creative approaches to milk marketing.

One promising approach is to encourage the production and marketing of specialty cheeses.

The second strategy for sustaining Midwest milk production is achieving greater efficiency within our dairy manufacturing infrastructure. Finally, there are opportunities for Midwest producers to supply fluid milk to the class I market in areas where the local supply is inadequate.

In order for this to work, the Federal Milk Marketing Orders have to be flexible and adoptable enough to facilitate movement of milk to milk deficient regions. We do want to be able to supply high-value class I markets when the local supply is inadequate, and milk marketing orders should not inhibit that from occurring.

We have the resources, experience, and capability to be a leader in our national dairy industry. But it will take hard work on the part of producers, cooperatives, and Federal policymakers to realize our full potential. As lawmakers, we simply ask that you support public policies that give us a level playing field and tools to help ourselves build a promising and prosperous future. Thank you.

Mr. GUTKNECHT. Thank you, Mr. Clark. Are we going to visit his farm? We're going to a farm near Rollingstone. Thank you for coming.

We're running short on time. I'm not going to ask as many questions. I want to bring up the third panel. But Mr. Vrieze offered a rather sober, and some might say fairly harsh, observation about the current milk marketing order system, classification system. Would you care to respond to his comments, Dana?

Ms. ALLEN. Thank you, Chairman Gutknecht. We certainly agree with points that.

Mr. Vrieze has raised. The system is antiquated and probably——

Mr. GUTKNECHT. So things have changed since 1934.

Ms. ALLEN. Certainly things have changed. We'd transport cold milk to Florida, if need be. Minnesota Milk would like to see a uniform class I utilization rate across the country. Right now we feel that the upper Midwest is set at a disadvantage.

Mr. GUTKNECHT. And you would agree that California has to be part of the final solution.

Ms. ALLEN. I would like to see California as part of the solution.

Mr. GUTKNECHT. And he is correct. They have 54 Congressmen, so we do pay attention.

Ms. ALLEN. And I know a fair number of them are also on your subcommittee. But we also feel that it's important to maintain a classing system, whether that incorporates milk protein concentrate somewhere in there, it doesn't quite provide the incentive to produce nonfat dry milk, but allows us to adapt to new technologies. But we believe that would maintain the structure and order within the pricing system. And it might become just as complicated to figure out what my price of milk would be if I have no idea what it's going to be used for.

Mr. GUTKNECHT. So you're saying we should have a class V.

Ms. ALLEN. Maybe we should have a class V. Thank you.

Mr. GUTKNECHT. Mr. Maas.

Mr. MAAS. I think we need to remember that the Federal order system, initially its main purpose was to provide an adequate supply of dairy products to all areas of the United States. And I don't think we can lose sight of that fact, and I think that's why we need it. Yes, maybe it needs some tweaking from time to time, but most things do. And I'd really—I think especially for the Midwest and the processing area up here, it's definitely needed.

Mr. GUTKNECHT. Mr. Clark, do you want to add anything? You're sort of in between the two sides, representing a fairy sizable coop.

Mr. CLARK. I know it's an awfully complicated system. It would be nice if even I could fully understand the system before, say we should keep it or get rid of it. I wish you'd come up with something just a little simpler.

Mr. GUTKNECHT. So do I. Listen, I'm going to dismiss you, because we've got another great panel. And I want to thank all of you, but I think this panel probably really represents the differences on this whole issue, and we are in that phase right now of listening and learning, and hopefully these aren't irreconcilable differences. Let me just say this. That many people, if we don't always agree with some groups, people say we're not listening. No, we're listening, but we're listening to lots of different folks about what's going on. And what ultimately we hope to determine is what is best for the dairy industry in the United States, and what is best for me, what's best for the dairy industry here in the upper Midwest. So I want to thank you all, and we look forward to continuing this discussion and dialogue as we begin to get closer to actually drafting the next farm bill. Thank you very much.

Next we're going to call up our third panel. We first have Mr. Clint Fall, who is the president and CEO of the First District Association, from Litchfield, Minnesota. Mr. Jim Green, who is the president and CEO of Kemps, from Saint Paul, Minnesota. And as already referenced, Mr. Mark Davis, who is the president and CEO of Davisco Foods International, from Le Sueur, Minnesota. And Mr. Gordon Crow, who is the director of Government and Community Relations, or what we used to think of as a little ice cream company in Marshall, Minnesota, Schwan, but they are much, much more than that. They are a huge consumer of dairy products all over the United States. And we thank all of you for coming today, and your comments, both written and oral, will be made part of the official record.

Mr. Fall.

**STATEMENT OF CLINT FALL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FIRST DISTRICT ASSOCIATION, LITCHFIELD, MN**

Mr. FALL. Well, thank you very, Chairman Gutknecht, for this opportunity. My name is Clint Fall, and I'm the president and CEO of First District Association in Litchfield, Minnesota. Thank you for this opportunity to testify today regarding the status of the upper Midwest dairy industry.

First District Association is a dairy farmer-owned cooperative based in Litchfield, Minnesota. The farmer-members of First District produce 1.7 billion pounds of milk per year, over 120 million pounds of cheese each year, over 22 million pounds of various forms of whey protein concentrate, and 32 million pounds of lactose on an annual basis. Our single cheese processing plant in Litchfield is one of the largest and most modern dairy processing facilities east of the Mississippi River, and one of the few processing plants with the technical capability of extracting dairy calcium.

Farmer-owned cooperatives such as First District Association are critical in the dairy processing sector, not only in the upper Midwest, but in the Nation as a whole. In Minnesota and Wisconsin, about 85 percent of the milk is marketed through cooperatives. It is estimated that 60 to 65 percent of cheese, and nearly 100 percent of butter and milk powder in Minnesota and Wisconsin are processed by cooperatives.

As a member of the Midwest Dairy Coalition and the National Milk Producers Federation, we are also active in supporting Federal dairy policies that are beneficial to dairy farmers of the upper Midwest and the Nation as a whole. The structure of Federal dairy policy has always played a significant role in the status of the upper Midwest dairy industry, although not always for the better. Whether it is the ongoing structure of the Federal Milk Marketing Order system or past experiments with regional dairy compacts, Federal dairy policy has often placed the upper Midwest at a competitive disadvantage by artificially inflating class I prices and putting downward pressure on manufactured milk prices. Since about 85 percent of the milk in the upper Midwest is manufactured into cheese, butter, and powder, such policies are detrimental to our region.

Therefore, one of the clear policy objectives has been to promote policies that treat producers in the upper Midwest equitably, and to reform or eliminate those policies that discriminate against our region.

As we move into the debate over the structure of the next farm bill, I would like to make several points about policies that are important to the upper Midwest dairy industry.

Number 1, the Milk Price Support Program. Without a doubt, the Milk Price Support Program is an important program that should be continued. But it is also in great need of reform.

The current price support level of $9.90 per hundredweight has proven to be a porous and ineffective floor. Between January 2000 and February 2003, the class III price fell below the support in 12 of the 37 months, falling as low as $8.57 in November 2000.

The central premise of the program is that dairy product manufacturers will sell dairy products to the Commodity Credit Corporation whenever markets fall below the product purchase price as established by USDA. Yet, manufacturers are reluctant to sell product, particularly cheese, to the Commodity Credit Corporation, CCC. One of the key reasons for this is that the costs of selling to the CCC are higher than the costs of selling to the commercial market. To more adequately reflect the unique and added costs associated with selling to the CCC, we support a proposal by National Milk Producers Federation to increase the purchase prices for cheese, nonfat dry milk, and butter.

Number 2, the Milk Income Loss Contract Program. Because of the inadequacy of the Milk Price Support Program, First District Association and the upper Midwest Coalition argued during the last farm bill debate for an additional program to provide a more credible safety net for dairy producers. Fortunately, others agreed. The counter-cyclical Milk Income Loss Contract Program that emerged out of the 2002 farm bill is working and has proven to be a very effective safety net for farmers in the upper Midwest, as well as throughout the country.

Because of the counter-cyclical nature of MILC, assistance is only provided to producers when market prices fall below a certain target level. Indeed, the MILC Program was dormant for much of 2004 and 2005. However, when prices do fall to low levels, as they did in 2002 and the first half of 2003, and as we are currently seeing, the assistance provided by the MILC Program is critical.

Congress also sought to limit the taxpayer costs of the MILC Program by placing a volume cap to limit the benefits to the first 2.4 million pounds of production per operation. Roughly equivalent to the production from 135 cows. All producers are eligible for benefits, but not beyond the 2.4 million-pound annual cap. Over 83 percent of all dairy farmers—or dairy farms in the Nation receive full benefits of the MILC Program and are fully covered under this cap. Yet, even those that exceed the cap receive great benefits.

The MILC Program has proven to be beneficial to a vast majority of dairy farms in the Nation. And for the upper Midwest specifically, there is no doubt that the program has helped maintain a productive capacity during low milk price cycles. In that context, it is worth noting that dairy cow numbers in Wisconsin increased in 2005. This is the first time since 1994 that January through December dairy cow numbers in Wisconsin have not shown a reduction. Arguably, the MILC Program is one of the factors helping to stabilize dairy production in our region.

As we move into the next farm bill debate, it is critical for our dairy industry and our rural communities that MILC or a similar type of counter-cyclical safety net program be continued.

Number 3, trade policies. It is critical that we review our trade policies and those of our trading partners to assure that we have consistent and rational policies as we move into the future. Specifically, during the Uruguay Round of WTO trade negotiations, tariff rate quotas were placed on imports of traditional dairy import product classes such as cheese, butter, and nonfat dry milk. However, we failed to recognize emerging trends in international trade, particularly with regard to milk protein concentrates, and we failed to create tariff rate quotas on those milk protein products consistent with butter and dairy product classes. As a result, we have seen instances during which MPC imports into the United States have surged.

In March 2001, the General Accounting Office study determined that MPC imports increased 56-fold from 1990 to 1999, with a near doubling of the MPC imports in 1999 alone. Not only do these import surges affect farmers' milk prices domestically, they also have a significant cost to taxpayers. In May 2004, a study by the International Trade Commission, it was determined that 35 percent of the CCC stock buildup of nonfat dry milk between 1996 and 2002 was attributable to the displacement of domestically produced nonfat dry milk by imported milk protein products.

MPC imports are once again increasing. It is critical that we modify our tariff schedules to place tariff rate quotas on MPCs and casein, as proposed in H.R. 521, introduced by Congressmen Obey and Sherwood. This legislation would place commonsense limits to assure that the United States does not experience major surges of MPC imports again, as we did in the 1990's. It is time for us to push for more consistency in our tariff schedules and to fully recognize and respond to our own market vulnerabilities.

The upper Midwest dairy industry is in the process of becoming more competitive. Our region will continue to enjoy more comparative advantages in dairy production and processing. However, we must work together to achieve necessary efficiencies to remain competitive, especially with the West and the Southwest. This will likely require modifications in traditional premium structures, as well as efforts to reduce the milk assembly and transportation costs. These changes will occur independent of Federal Government action. However, a Federal dairy policy will continue to play a role in the future dairy production and processing in our region. It is our job to insist on policies that treat our region fairly. Thank you very much for this opportunity.

Mr. GUTKNECHT. Thank you, Mr. Fall.

Mr. Green, first before I introduce you as the president of Kemps, I just want to say that we now have a rule in our house that we have to keep that new light ice cream in our freezer at all times, and so it is a fabulous new product, and I promote it everywhere I can. Thank you and Welcome.

**STATEMENT OF JAMES B. GREEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, KEMPS LLC, ST. PAUL, MN**

Mr. GREEN. Well, thank you, Mr. Chairman. Thank you for that nice comment, and we think it's a great product too, and it's doing well in the marketplace.

Mr. Chairman, as you mentioned, my name is Jim Green. I'm president and CEO of Kemps, LLC, a Saint Paul-based dairy company that manufactures and markets a wide variety of dairy products; including fluid milk, cottage cheese, sour cream, dips, and yogurt. Kemps is a wholly-owned subsidiary of the H.P. Hood Company, one of the largest dairy companies in America.

I also serve, have the pleasure to serve as the chairman of the International Dairy Foods Association, as well as the chair of the International Ice Cream Association. So we appreciate very much the opportunity to provide a Minnesota perspective on dairy policy.

The dairy industry faces some unique challenges in the Midwest, but we share a national belief that the U.S. dairy industry is the best in the world. I would like to focus first on the Federal Milk Marketing Order Program, and then suggest some guiding principles that can be used when you write the next farm bill. Bring some, I think, some Minnesota commonsense to the complex maze of dairy regulations.

In many respects, classified pricing is the root of many of the industry's problems, particularly in this part of the country. The Federal Milk Marketing Program has been around since the Great Depression. Almost as long as Kemps. Unfortunately, the system has not kept pace with the changing nature of the dairy industry. The complexity of classified pricing and the stagnation of the Federal Milk Marketing Orders, which aren't like any other commodity programs in America, have created a system of milk price regulation that often stands in the way of milk moving to its highest valued use, and milk moving from the highest, most efficient production areas.

In Minnesota, the classified pricing scheme of the orders has caused regional price distortions that raise serious long-term issues concerning sustainability and fairness for both dairy farmers and processors alike. As a result, the Federal Milk Marketing Orders keep us at a competitive disadvantage in today's marketplace.

Seventy years ago, milk was the beverage of choice for most Americans. Today, milk competes directly with a wide variety of other beverages; including bottled water, fruit juices, and carbonated soft drinks, none of which are subject to Government-run classified pricing schemes.

Globally, only America and Canada still maintain rigid milk price setting regulations, while our competitors, like New Zealand and Australia, have no such regulations. Even emerging international dairy markets like Russia and India and China have avoided the American model, sending clear signals that we need to change the way we do dairy in America.

Beyond the complex web of Federal Milk Marketing Orders, the United States has two countervailing dairy subsidy programs that USDA found in 2004 to do little to help the dairy farmer. The Milk Income Loss Contract Program, MILC, and the Dairy Price Support Program are at odds with one another. MILC stimulates overproduction, depressing prices, and causing great price instability in the marketplace. While the Dairy Price Support Program makes the Government an active, willing buyer of dairy products, preventing markets from clearing properly when products are in surplus, and artificially interfering with the commercial marketplace.

Unfortunately, we cannot fix all the problems with the Federal dairy policies overnight, but we can initiate a transition from a multiple, divisive, and costly subsidies, to a single, national dairy farmer safety net. We can create a more level playing field for all producers and processors so that we can compete fairly and equitably. The next farm bill provides a historic opportunity for Congress to begin this process to ensure that the U.S. dairy industry will be more prosperous in the future.

We can accomplish this goal if we work together and come to a consensus on the basic principles for a more modern, market-oriented national dairy policy.

First, it's important that policies allow market signals to work so that our products can be the most competitive and innovative in bringing consumers what they want and what they're willing to buy. Second, while there are certain regional differences in our industry, it's important that Federal dairy policies be national in scope, recognizing national and even global markets for our products. Third, policies should be designed to minimize Federal Government expenditures. And, fourth, there should be a single national safety net for dairy farmers that minimizes market interference as much as possible, is consistent with our trade policies and objectives, and yet still provides critical assistance when it's needed.

The dairy processing industry is committed to these principles and believe they are the foundation for our future; providing producers and processors the greatest opportunity for strong growth and future prosperity.

I commend you for holding this hearing and gathering a diverse group of industry representatives together to share our differing opinions, and I appreciate the opportunity to testify very much.

Mr. GUTKNECHT. Thank you, Mr. Green.

Mr. GUTKNECHT. Next we're going to hear from Mark Davis of Davisco in Le Sueur, Minnesota. Welcome.

## STATEMENT OF MARK DAVIS, CHIEF EXECUTIVE OFFICER, DAVISCO FOODS INTERNATIONAL, INC., LE SUEUR, MN

Mr. DAVIS. Thank you, Mr. Chairman, and thanks for allowing me to testify. Let me premise my remarks by saying that after listening to most of this testimony, that it would be my considerable judgment that the upper Midwest has the potential to be the best place to produce milk in the country.

Having said that, and by way of introduction, I represent the second generation in our three-generation family manufacturing business. We have factories in Idaho, South Dakota, and Minnesota. We have recently invested with a grain farmer and a dairy farm in southern Minnesota, and on that farm we practice some of the things Mr. Vrieze alluded to with anaerobic digestion and making our own electricity, and I would tell you there's more about cows that I wish I ever knew, but now know.

We have done a good share of research and innovation on the whey side or the byproduct side of our cheese business. We have sales offices in Mexico City, Geneva, Switzerland, and recently opened an office with a staff of two in Shanghai, China, because of the opportunities we see on the whey side of the business. And I think from our experience on the whey side, that creates my frustration with the milk side. And having lived under the order system as a private company, has had it's moments, but it's also been inspirational as you try to figure out how to fight the system.

And I would tell you that I don't want to give an insane suggestion, but when I listen to all of the possible suggested cures for the order system, why don't we try the marketplace. Why don't we just do our business and sell our products as other industries do. I just cannot believe that our dairymen, having established in various parts of the country what they have, won't be able to compete in that type of marketplace.

Now, particularly as to the Support Program and the MILC Program, when you consider that MILC is capped, as has been stated here, at 2.4 million pounds, and yet evidence seems to say that the people that live with the cap and are entitled to the full subsidy are the people that are growing their part of the industry. They're growing in milk production. I think that says something.

I think milk flies somewhat in the face of the Support Program in that it encourages people to quit producing. It encourages people—or discourages them from having price be an incentive to change their practices, to invest in technology, and that's both on the producer side and the manufacturing side.

I can tell you from our experience that the Midwest manufacturing sector is at a disadvantage under this system. That those manufacturers that are comfortable and secure in the fact they can invest in bigger and larger plants with new processes are doing that. And with a declining number of dairy farmers in the Midwest and declining milk supply, you have to be somewhat reluctant to present some kind of a financing proposal to your banker. It's just not confidence building and a very delicate place to invest in new factories.

The Support Program dictates economically that we should produce cheese, butter, and nonfat milk. In our world, we found that whey, with no regulations and with an open marketplace and prices that are determined in the marketplace, has proven to be an opportunity. And not only that, whey protein, which is the natural byproduct of cheese-making, offers many, many benefits that were intended to raise a calf and can be used for human purposes in nutrition, weight loss, muscle building, any number of areas that are healthy and nutritious for people.

When the Government does accumulate supplies of nonfat milk and build that up to the level where they have to release them, those releases dramatically affect the price of dairy proteins and distort the marketplace.

People have suggested raising the support price. I don't think we need a support price. Our industry has the capability to be dynamic at the producer level, and certainly at the manufacturing level, to respond to the prices as they're presented in the marketplace. Oftentimes good judgment is dictated not by what a market is telling you, but by what a Federal policy does to your economics, and I think that's unwieldy.

And, finally, we previously had a program that allowed folks like us to offer futures contracting to our milk producers. Now, having had experience on the dairy producer side where we have a dairy farm and have utilized that service, we find that to be most beneficial and most helpful in making long-range planning. If you can lock in a price on your product and be comfortable, you're going to have those economics, at least to a large degree, throughout the year. It opens many more options and opportunities for you.

So I would encourage your committee and you encourage the Government that a program that worked for 5 years with no distortion, no negative impact on Federal orders, should be reinstituted. And as a private family business, we'd be offered the same opportunities to forward contract as a cooperative would have. So with that, I appreciate very much the opportunity to be here and look forward to your findings.

Mr. GUTKNECHT. Well, thank you very much, Mr. Davis.

I want to thank you for the little plug for the Futures Program. I was the chief author of that, so——

Mr. DAVIS. I knew that and I should have said that.

Mr. GUTKNECHT. Well, ideally children are brilliant when they're your own, or I should say ideally grandchildren now are brilliant when they're your own, but I want to thank you for that. I also want to thank you for helping to educate me about, you were really a pioneer when a lot of other dairy co-ops and dairy processors and manufacturing plants around the country were literally flushing down the drain value in these whey products. You were the first to really recognize the value, and you have really opened up a whole new marketplace for things that we used to throw away, and I want to congratulate you and your family for that.

Next we're going to go to Gordon Crow, and before I introduce him, let me tell you a little bit about their little company. Probably because they're a privately held company, people know very little about Schwans. They see the trucks. They don't realize how much dairy product they buy every day. And I think I'm right in this, Gordon, you have a pizza plant down in Kansas that consumes more cheese than all of the dairy cows in the State of Kansas can produce. It gives you some idea of how much cheese and pizza you folks sell. So, Mr. Crow, we want to welcome you and thank you for joining us here today.

**STATEMENT OF GORDON CROW, DIRECTOR, GOVERNMENT AND COMMUNITY AFFAIRS, THE SCHWAN FOOD COMPANY, MARSHALL, MN**

Mr. CROW. Thank you, Mr. Chairman. I was heartened to come here and excited to learn that you have ordered that the Kemps ice cream be kept in your freezer. I'm assuming by extension you're extracting the Schwan product and consuming it.

Mr. GUTKNECHT. That was a faux pas on my part. We always keep Schwan's drumsticks available, but I haven't seen you have a light product, and for those of us who are getting paunchy in our middle age, we do like the lighter product.

Mr. CROW. I will quickly and severely follow up on that, because we do have a few of those, and most of them made with Davisco cheese, I might mention.

Chairman Gutknecht, as you've introduced, my name is Gordon Crow. I'm the director of Government and Community Affairs for the Schwan Food Company. We're based in Marshall, Minnesota. I want to thank you for holding this timely hearing in Minnesota and inviting Schwan to testify on the many important dairy policies affecting our industry today.

The story of Schwan exemplifies the spirit of American entrepreneurship. Marvin Schwan started selling and delivering ice cream to rural homes in southwest Minnesota, it's about 300 miles west of here, in March 1952 out of the back of a dilapidated 1946 Dodge panel van. At the time, Mr. Schwan and his parents ran a small dairy that was struggling, due to, ironically, Government price controls on milk.

Today the Schwan Food Company is one of the largest branded frozen food companies in the world. It is a multi-billion dollar international corporation, with major manufacturing operations in eight States, and three countries in Europe. Schwan employs about 22,000 people worldwide. Our brands can be found in more than 50 countries. Schwan's products can be found in homes, supermarkets, convenience stores, public and private schools, military dining facilities, hospitals, universities, and many restaurants and entertainment venues. Seven out of the 10 school lunchrooms carry our products, and about three-quarters of the frozen pies sold in America are manufactured by Schwan. It is reasonable to assert that Schwan is a local company that competes in a global market.

Mr. Chairman, as you know, the Federal dairy policy rules of today were laid out even before Schwan existed; before interstate highways; before dependable refrigerated hauling. Most of the policies, as it was mentioned earlier, were created during the Great Depression, when the factors of trade in America and internationally were dramatically different. A tremendous opportunity exists for the U.S. dairy industry in today's marketplace. While I do not buy and sell commodities for Schwan, I have consulted with our commodity group and can tell you, in order to take advantage of this opportunity, we must look to our vast number of commodities that are succeeding without layers of subsidies. We must adopt a coordinated Federal dairy policy that is flexible, market-oriented, and environmentally sound.

Let me illustrate my point. At Schwan, frozen pizza is one of our signature products. To make pizza, we need dough, sauce, cheese, and toppings. I'm here to tell you that no other industry we deal with in the making of frozen pizzas face the same challenges as the dairy industry.

The Government does not tell the flour mill from which we buy wheat what they must pay their wheat farmers, or the tomato paste manufacturer what it must pay tomato farmers for their perishable product, or the pepperoni company what it must pay the beef rancher. Equally confounding, with each of these ingredient providers, we have the opportunity to contract for a specific amount of product at a mutually agreed upon price, which is always a fair price. We are prohibited from forward contracting for our dairy ingredients based on the unfounded fear that dairy farmers would in some way be harmed if we were allowed to voluntarily negotiate a fair price for the dairy products we buy.

No other commodity has regulated prices like dairy. Wheat growers and other program crops, for that matter, have a safety net that allows them to preserve farmer income while at the same time clearing the market of surplus. Tomato producers do not have a Federal safety net. They rely on forward contracting, and it's working well for them. Moreover, cattlemen, free from the restrictions of dairy-like pricing regulations, have been, and continue to, develop a variety of products that the consumer wants; whether it's lean beef, naturally produced, certified Angus, aged beef, guaranteed tender, or so forth, they have that free.

My point is, Congress needs to take action by overhauling our current dairy policy so that the companies like Schwan can remain competitive in local, national, and international markets. While a lot has changed since the 1950's at Schwan, the same cannot be said for the policies and regulations for milk and dairy products. These have our markets in a stranglehold, it is our opinion. Let me suggest a new policy direction for dairy should address two key changes from the current antiquated system.

First, we need to change existing subsidy programs that weigh us down. As you have already heard in testimony from across the country, the Milk Income Loss Contract Program and Dairy Price Support Programs simply work against each other. They create a heavy financial burden for our Government and interfere in the marketplace. In fact, as many have expressed, these inefficient programs work at cross-purposes and distort dairy market signals. We need to make sure that any new system affords assistance to the entire dairy industry, while letting markets dictate production.

Mr. Chairman, Schwan supports the existence of a safety net for dairy farmers. However, we support one that allows markets to operate unobstructed, while still providing critical support for farmers. We cannot continue to suffer under two conflicting subsidy programs like the wheat industry did some years ago.

Second, we need to open dairy markets at home and abroad. Trade restrictions on items such as MPCs, milk protein concentrates, caseins, and caseinates, or import assessments on similar products are simply bad ideas from the past. There are companies now making these highly refined dairy proteins in this country every day, and, I might add, doing so successfully without having to rely on support programs, Government subsidies, or regulated minimum prices. And restricting access to imported ingredients hurts our trade credibility and our Minnesota businesses. American policy must set the standard for increased market access and efficient production, both at home and abroad.

The Federal Dairy Price Support Program is the main reason that the United States is not a world leader in the production of value-added dairy proteins, because the program makes it more profitable for companies to sell nonfat dry milk powder to USDA than to invest in technology to make MPCs demanded by the market. I know you're familiar, Mr. Chairman, with the International Trade Commission Report that concluded that U.S. production of specialized milk proteins is limited and likely to remain limited so long as the current Federal Milk Marketing Order and Dairy Price Support Program remain in effect. The market needs these proteins, and we need these proteins for our dairy industry to grow, so it's up to Congress to reduce the policy obstacles which stand in the way.

America's dairy industry must maintain its strong global position. In fact, the combination of the Doha Development Agenda in the WTO, U.S. free trade agreements, and the farm bill renewal process are all aligned to provide us with a historic opportunity.

We now sit on the verge of arguably the best opportunity we've had in decades to get our policy cards put together in a way that gives the United States the best hand at the table among major dairy producers in the world. We must not waste it. We should also not sit in a defensive policy crouch, blame others, and squander this chance to build a better policy platform that encourages our already enormous efficiencies and resources to grow even more.

However, Mr. Chairman, with or without an agreement out of Doha, it's imperative that we remain committed as a Nation to see that commerce, not Government regulations, guide the investments and production decisions companies like Schwan make every day.

Mr. Chairman, the Schwan Food Company prides itself on making products with the highest quality dairy ingredients. It is a pride that can be shared by all American dairy farmers. Farmers and processors are involved collaboratively in today's business environment, and we must do the same on the policies. Let us work together to maintain that standard of quality and address these pressing issues. I am confident we can rise to the challenge so that our next generation of Schwan employees worldwide can continue the rich tradition established by Marvin Schwan 54 years ago. Schwan and the dairy industry stand ready to help you in this endeavor.

Again, thank you for this opportunity to testify. I appreciate your leadership.

Mr. GUTKNECHT. Thank you, Gordon, and, again, thanks to what your company does every day in terms of moving enormous, in fact, mountains of dairy product around the country and around the planet, literally.

You talked a little bit about foreign markets, and I know you've opened a big plant in Germany, and you're doing some interesting things there. Can you talk a little bit about that, where you see that going in terms of expanded markets. I know you sell an awful lot of pizza, even in Central and South America.

Mr. CROW. Oh, I think, the same thing that Mr. Davis talked about, Mr. Green talked about, other manufacturers here, is we are looking to world markets more and more, and as you know, some of the steps and actions we've taken with the Government here have proved problematic in those areas. We have manufacturing facilities, two in England, one in France, one in Germany. We actually dominate the frozen pizza market in Europe today, and we have other branded foods over there. But the big challenge is the protectionist policies, or what they see as protectionist policies for U.S. types of produced and grown and manufactured things. It may have little or nothing to do with what we're meeting here today about, but it's still some hurdles and some obstacles that are put in our place that damage our reputation or our credibility on a national level.

Interestingly, on the previous panel, we heard people talking not about protecting America businesses and producers, but down to regions. Now we have different agreements for different regions of our own company. I will agree with Mr. Davis that we need to bust down our own—we need to clean up our own house first, through either one policy or a simplified policy or something like that, and then send the same signal out to the rest of the world.

We are, incidentally, which you're aware of, we have recently moved into Central and we're moving into South America with our products, so all of this is very timely to us in our plans for growth internationally.

Mr. GUTKNECHT. Mr. Davis, you mentioned China, and you've opened an office in Shanghai, I believe.

Mr. DAVIS. Yes.

Mr. GUTKNECHT. Can you talk a little more about that, because I'm fascinated, because we've begun to discover that even though 50 percent of Asians are lactose intolerant, if you turn it into cheese or whey products, there's a tremendous market over there.

Mr. DAVIS. I don't think the Chinese know they're lactose intolerant. That's an American newspaper——

Mr. GUTKNECHT. Is it a myth?

Mr. DAVIS. I don't know if it's a myth either, until you get some consumption there.

Mr. CROW. Let's not tell them. Let's see what happens.

Mr. DAVIS. Just see what happens. But it's a very exciting place. We think if we have 74 cows, it's small in Minnesota. Well, China probably has an average of six, if you take the country as a whole. If you try their products in the supermarket, they're terrible. They're worst tasting than, sorry, Jim, UHT milk, but it's just the place to be. It's going to happen.

When they're consuming the low volume per person that they're consuming, it's a huge opportunity, and they lack the technology, they lack the sophistication and knowledge of our producers over the European producers. If they double, and they only go up to 6 pounds, it could take our entire surplus of products in those years we have it, just like that, and still need New Zealand and Australia.

They're just anxious and aggressive about getting what we've got. That's the best I can say about it. I don't have any technical knowledge about what they're doing, but, boy, there's opportunity over there.

Mr. GUTKNECHT. Mr. Green, you talked a little bit about growth opportunities for this industry. You want to expand on any of that?

Mr. GREEN. Well, from Kemps' perspective, we see tremendous opportunities in terms of growth, not only within Minnesota, not only within the upper Midwest, but also interregionally and going to other parts of America. One of our strategic intents as a company is to grow outside of the upper Midwest and to explore new markets, particularly in frozen deserts and cultured products, so Kemps is all about innovation. You mentioned a new product that we have, but there's many more to come. But as we innovate, we also need efficiency relative to our plants, but then we also need to be able to buy and purchase dairy products from efficient producers. And that's some of the points that I made in terms of my testimony was from the perspective of two countervailing policies that work against one another and, unfortunately, it creates a distortion in our markets and provides the wrong trigger points relative to the marketplace, so, yes, we see an awful lot of future and an awful lot of promise relative to innovation, but we need efficient markets to operate as well.

Mr. GUTKNECHT. Mr. Fall, my staff doesn't like it when I do this to them, but I have a rule that we don't use the word safety net in our office, and there's a specific reason for that. I think taking it in today's world, it has the wrong kind of connotation. The term that we use is a shock absorber. And I like that term better, because I think it really speaks to what I think we do need to do. I mean, there has to be some Federal shock absorber under this—and you talked about volatility of the market. Do you think it's possible that we may be able to craft something that takes, perhaps, the best elements of the MILC Program and the other minimum price programs and so forth, is there a way we—do you think there's a way we might be able to come up with a simpler, fairer, more understandable system in this next farm bill.

Mr. FALL. I guess I'll answer that, Chairman Gutknecht, by saying, yes, I do believe that there are opportunities. I maybe am not in total agreement that the current price support program and the counter-cyclical program that we call MILC conflict each other. In fact, I think, quite frankly, they somewhat compliment each other. They work a little bit differently. The Support Program, or the Shock Absorber Program, whatever you want to call it, the safety net, it basically functions as a clearinghouse for commodities that are produced in the country. There are problems with the program, as we mentioned, that it's become very complex to use it, with the exception of moving nonfat dry milk into that marketplace.

On the other hand, the counter-cyclical program has been a very effective program. When the market drops below a certain level, it's dollars that go directly to the dairy producer. It bypasses the processors. Whether the processors are in cooperative or whether they're private, it's money that goes directly to that producer, because the price dropped below a certain level, and it provides them with that needed income.

My experience, quite frankly, and I'm very close to the farm side, First District has 1,300 members, and my experience in the last several years has just been very positive from the standpoint of seeing some enthusiasm, finally, in this region of the country, and I've worked in all regions of the country. And with the advent of the counter-cyclical program, we've seen some additional dollars be put into the pockets of people who are feeling more comfortable with reinvesting and modernizing.

I think we all agree that we need an industry that has modern facilities and efficient facilities, but the unfortunate part about it in the upper Midwest is our producers have not had the luxury of selling real estate in certain areas of the country at hundreds of thousands of dollars an acre to reinvest in dairy operations. So we have to take it at a little bit different approach, and the counter-cyclical program has functioned very well in this part of the country, as I think in other areas as well.

Mr. GUTKNECHT. Mr. Fall, I want to thank you for—and unfortunately you brought that up at the very last minute. I mean, that is a growing concern that we have, is that you've got producers in California that can sell their operations for huge amounts of money, and they can go to New Mexico, or even as was indicated earlier, some are coming back here to the upper Midwest and looking at expanding dairy operations. That is an interesting and, albeit, very difficult thing for me to unravel, how that all effects.

Let me close this down, because one of my goals was to start on time and finish on time, and we're a little bit late. I want to thank all the people who have testified today. I want to thank our staff who have done a marvelous job in helping put this together.

Let me just say in conclusion that as we go forward and have more of these kinds of meetings, both here and around the country, I will say this, and I want everybody to understand, I'm not going to be a party to pulling the rug out from under our dairy farmers. I mean, first and foremost, they are, in some respects they are the mortar that hold the bricks of rural America together, and so the dairy industry is extremely important.

Having said that, I think we have to be cognizant of the fact, and part of the reason we've got folks from Kemps and Schwans and Davisco here, is because we have to understand that they're important to our future as well. And I think some of the things that they've said today cannot be ignored. We have to come up, in my judgement, with a simpler system that's both fair, and that is rational in terms of meeting market demands. And so we've got a very difficult future ahead in terms of dairy policy, and how do we bring these various conflicting regions and viewpoints together and come up with a rational policy that allows dairy farmers to flourish, particularly here in the upper Midwest, and allows us to compete in what I believe will be a growing international marketplace for the things we can produce here in the United States.

And as I mentioned earlier, it surprises me sometimes that dairy industry officials from small countries like Ireland and New Zealand seem to have more faith and confidence in the future of the dairy industry here in the United States, sometimes, then even we do, and we're trying to explore that and get to the bottom of that.

With that, I will close the formal portion of this meeting, and we're going to be around here. And I think later this afternoon we're going to be doing a few tours of dairy farms here in this part of the world. But, again, thanks to all of you for coming out today. I will declare this forum adjourned. Thank you.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

## STATEMENT OF DANA ALLEN

Mr. Chairman, and members of the subcommittee, my name is Dana Allen. I own and operate a dairy with my parents and brother south of Eyota, Minnesota, which is about 50 miles west of where we are today. I am proud to be a fourth generation dairy producer.

In addition to operating a dairy, I also serve on the board of directors for the Minnesota Milk Producers Association, the Voice of Minnesota's Dairy Industry. Minnesota Milk, as we are known, has a growing membership of over 1,800 dairy producer members. We combine dairy producer leadership with over 250 associate members and we are "The Voice of Minnesota's Dairy Industry". Our strength comes from working together with industry partners to create more opportunity for dairy producers. We focus on educational programs as well as mobilize grass roots efforts to help set policy that will shape our future.

First, I want to thank Chairman Gutknecht, my Congressman, for holding this field hearing in our area. As Congressman Gutknecht knows, the southeast portion of Minnesota has a long standing tradition of being a strong, progressive dairy area. Our terrain of rolling hillsides provides many opportunities for forage production and environmental sustainability. Dairy farming lends its hand to such opportunities.

However, over the last 30 years, Minnesota's dairy industry has faced many challenges. I sit before you today as a true minority in the dairy industry, a female. And, also as a representative for the next generation—the future of Minnesota's dairy industry. I am not interested in talking about the problems of the past, rather, I want to talk about what we have learned from these challenges and transform them into opportunities for our future.

Our 5,126 Minnesota dairy farms have an average herd size of about 74 cows, one of the smallest averages in the Country. While we can celebrate the fact that dairy producers in this part of the Country have been able to make a living on fewer cows than our counterparts elsewhere, we must continue to get better and that sometimes means increasing the pounds of milk produced, either by adding cows or increasing pounds of milk per cow. It could also mean adding more value to our product, cutting costs of production per pound produced, or any combination thereof.

In addition, consumers continue to demand low cost, high quality food. Consolidation is occurring all around us. Look at the explosion in major food retailers such as Walmart, Costco, et cetera, and the current purchase of Albertson's by SuperValue. As producers, we are continuing to adjust to the changes in the retail food industry. This trend continues to put pressure on the processing and production side of all industries, including dairy.

Coupled with that, we have a new generation of dairy producers coming up, like myself, who do want free time. I have chosen dairy farming as my career because I love the animals. There is nothing better than helping to deliver a newborn heifer calf or having the 4fourth highest milk production per cow in the State of Minnesota. But there are also business realities that must be faced. Consolidation is one reality, the need to hire additional labor is another. If not addressed, Minnesota's industry will continue its decay and the incentive for young people to come back to farm will soon disappear.

I share this with you to give you a better understanding of the dairy producer perspective. Every dairy producer's dream is to own and operate a profitable and successful business while enjoying a wholesome lifestyle.

Overall, Minnesota's dairy industry has been able to maintain itself the last several years, which is an improvement from previous decades. In fact, we have even had some signs of strengthening. It has started with the resolve of dairy producers in Minnesota. We have been able to communicate our message to leaders at all levels to create policies that encourage a healthy and vibrant dairy industry.

Governor Tim Pawlenty, his administration, and several state legislators have played a major role in our effort and deserve our thanks. With their help, we have reduced the number of farm losses and steadied milk production. However, we still have a long way to go.

As we continue to stabilize and potentially increase milk production in Minnesota, our cooperatives and other processors must be looking at ways to increase processing capacity. They must also look into adding more value to what we produce on the farm. The adaptation of new technologies and improvements in efficiency are needed not only at the farm level, but also at the processor level.

Milk assembly costs from the farm to the plant are unacceptable. While they have made great strides over recent years, our processors must continue to work together much more than they are now to bring about increased efficiencies in milk assembly. They must also be constantly re-investing in processing procedures that add efficiencies to the system and value to our product. We will continue to work cooperatively with our processors to make these internal improvements in our industry.

There are several policies that need to be reformed and improved at a Federal level as well.

Policies are needed to help ensure that we have a quality rural labor force. For years, our best and brightest youth have been leaving rural areas. The supply of quality people is sometimes scarce. We have found that people of Hispanic origins share our values of family and work ethic. They provide a quality, trusted and hardworking workforce. We greatly value their contribution to our dairy and to our community.

We encourage Congress to pass comprehensive immigration reform that strengthens our borders, ensures national security, and provides opportunity for the United States to continue in its tradition as a melting pot of hardworking immigrants.

We request a price safety net that effectively sets a price floor higher than $9.90 per hundredweight. The safety net must work effectively within the market. Our current system tends to limit marketing innovation. Processors just produce products and sell them to the Commodity Credit Corporation when the market price for our product is at the price floor rather than encouraging dynamic marketing innovation.

Minnesota Milk believes a possible solution is to design a price support system that would work in combination with a counter cyclical program like the Milk Income Loss Contract (MILC) program.

The MILC program has provided enormous benefit to Minnesota producers. We strongly encourage Congress to continue some type of counter cyclical program. And, we remain open to possible changes in the system to reduce regional disparities.

Minnesota Milk also encourages Congress to continue to reform the Federal Milk Marketing Order system. The current system is antiquated and complex. We urge you to significantly reduce the number of Marketing Orders. Ultimately, we believe one marketing order is all that is needed. We believe the best solution is to create a system that incorporates one uniform Class I utilization across the country. Transportation has improved significantly since the inception of the currently reformed system. Cold milk can be efficiently transported across the country, thus eliminating the fear of having fluid milk shortages.

This reformed system would also encourage responsible dairy production in environmentally suitable areas of the country. It would also preserve orderly pricing and marketing of dairy products.

Additionally, we must have a domestic pricing structure that encourages the production of dairy products that consumers demand, in particular, milk protein concentrates. The current price support system and order system does not encourage balanced domestic production of proteins. For many reasons, it makes sense to ensure a domestic supply of a wide variety of natural proteins extracted from our cows' milk.

We encourage Congress to play an important role in WTO negotiations by not allowing other nations to export their subsidized dairy protein products into the United States. The bottom line is that United States producers can profitably compete with the best when we are on a level playing field. We encourage Congress to utilize Tariff Rate Quotas and other tools available to ensure we do not give away entry to our Country at the expense of the best dairy producers in the world—the U.S. dairy producer.

These changes can and must be made in such a way that maintains the integrity of the wholesome product our cows produce. Minnesota Milk encourages Congress and FDA to maintain a definition of milk, ice cream and other products that does not threaten the strong consumer confidence developed over the years which could be lost in the rush to sell dairy-like byproducts and imported substitutes in place of quality dairy products.

Environmental regulations in Minnesota are among the most stringent in the country. We are not complaining. In fact, we believe the responsibility of environmental protection should lie with the people who make a living off the land and we openly accept the responsibility. But, what we would like is to have other states step up and follow through on enforcing the Clean Water Act as it is related to livestock operations.

Consistent administration of environmental regulations across the country is fair and responsible. The current administration of the Clean Water Act puts producers in Minnesota at a competitive disadvantage because we are unable to reap the benefits of our high level of environmental stewardship from the marketplace. Instead, the current administration of the Clean Water Act should put Minnesota dairy producers at a competitive advantage—because of our special care for the environment.

To help dairy producers across the country comply with the Clean Water Act, Congress enacted the Environmental Quality Incentives Program (EQIP). It is one of the most valuable and reliable programs Congress has enacted. We ask that you continue funding EQIP at the current level or higher. Minnesota dairy producers understand the environmental rules and have grown to look at EQIP as a vital element in providing assistance needed to enhance their stewardship practices. We appreciate the 75 percent cost share limit established in statute. Unfortunately, in Minnesota, the administrators only allow 50 percent cost share of practices. Minnesota's State Conservationist, Bill Hunt, is doing a fine job of administering many aspects of the various conservation programs. However, this is one area that we would like to see immediate administrative changes. Environmental improvements on the farm can be quite expensive; increasing the cost share percentage to a number higher than 50 percent would benefit those that Congress intended the program to benefit.

Additionally, the EQIP program helps to prepare dairy producers for easy entrance into programs such as the Conservation Security Program (CSP). We ask that you consider continued, responsible development of a program like CSP that rewards producers for incorporating best management practices. The current CSP program holds promise for the future. However, there are still several questions associated with CSP before it becomes a truly effective and reliable program. We ask Congress to continue serious dialogue specifically with dairy farmers on how to best reform and implement the program before moving forward.

We encourage more cooperation between Federal conservation programs and voluntary, industry led programs like Minnesota Milk's Environmental Quality Assurance (EQA) program. The EQA program has received high praise from Minnesota officials like the Minnesota Pollution Control Agency Commissioner Sheryl Corrigan, Minnesota Department of Agriculture Commissioner Gene Hugoson and other state agency heads and environmental groups. These voluntary industry led programs help to extend Federal dollars farther and more efficiently. This is one particular area where Bill Hunt has seen opportunity. Bill and his staff continue to find innovative ways of cooperating and we thank him for his leadership in this area.

We encourage Congress to extend and expand renewable energy incentives not only for ethanol and biodiesel production, but also for on farm biogas production, in particular methane digesters. Minnesota is a leader in both biodiesel and ethanol production. Minnesota is also the home to dairy producer and Minnesota Milk Director, Dennis Haubenschild, who many consider a pioneer in creating renewable energy from cow manure. On farm biogas production holds promise as a key component for a stable, long term, domestically produced energy supply.

Lastly, Minnesota Milk supports and encourages continued development of a safe, secure and reliable animal identification program. Consumers are rightfully requesting traceability of food produced. The industry should be proactive by implementing an animal I.D. program. We ask that Congress consider the tremendous costs of implementing such a program. And request that these costs are not borne solely by producers, but rather consumers who gain from increased traceability of food products.

In closing, Minnesota Milk asks that Congress continue to have an eye for the future. As I mentioned at the outset, my generation is the future of the dairy industry. We must learn from the challenges of the past to reform and enact policies that will help cultivate profitable dairy producers who continue to care for the environment, and their communities. I believe the items laid out in my testimony and that of the other distinguished panelists help direct this vision.

Chairman Gutknecht, distinguished committee members, on behalf of Minnesota's dairy producers I thank you again for the opportunity to share our thoughts and ideas.

## STATEMENT OF MARK DAVIS

Mr. Chairman, thank you for the opportunity to testify today. members of the committee, welcome to Minnesota. And thank you for coming.

My name is Mark Davis and I've been in the dairy manufacturing business my whole life.

I was born into it. Growing up, my Dad was in the business. And my first job out of high school was driving a can milk pick up route.

I am now the President of Davisco Foods, a family owned company formed by the merger of the St. Peter Creamery and the Le Sueur Cheese Company in 1969. Our present headquarters is in Le Sueur, Minnesota. Davisco has cheese factories in

Le Sueur, Jerome, Idaho and Lake Norden, South Dakota. With ingredient spray drying facilities in Le Sueur, Nicollet, Minnesota and Lake Norden, South Dakota.

As our dairy manufacturing business has grown and evolved we've established sales offices in Mexico City, Geneva, Switzerland and, just recently, in Shanghai, China. We've worked with Japanese dairy processors for over 20 years.

When I was driving that milk pick-up route, I never dreamed milk production in Minnesota would drop more than 20 percent like it has between then and now.

So I want to take this opportunity to put some of those changes in context—especially with regard to Federal dairy programs, which haven't changed that much since I started in the business.

Let me comment first about one of the newest dairy programs:

MILC, or the Milk Income Loss Contract program.

Now, I know this thing is politically popular in the Midwest, but I have to call it like I see it. It is making dairy policy totally schizophrenic. It distorts the market signals.

It is the "Dr. Jekyll" program to the price support's "Mr. Hyde."

MILC is partially tied to production, but, only up to certain level of production. Many of the expanding dairy producers in the rapidly growing areas of the country are capped as to the volume of milk they can have subsidized.

MILC distorts the marketplace signals to the producers. They don't have to make economic and competitive enhancing investments, and, institute practices that increase their production efficiencies. One of the results being that Minnesota dairy farm production is not economically competitive with other growing production regions of the country. And soon neither will our manufacturing sector be competitive.

Thus, as prices recover, we, in the Midwest, will continue to lose dairy farms, and, discourage investment in what was once the premier dairy manufacturing region of this country.

So much for the market, and we manufacturers trying to make products and sell them.

MILC just makes a bad situation worse. Even without it, the price support program is causing serious problems in the marketplace.

Under the price support program handlers are essentially forced to make cheese, butter or powder. Why? If you try to make a derivative of one of those, the economics won't flow.

With this system, you are better off making nonfat milk, selling it to the government, and having the taxpayers supporting it. That whole system frustrates the marketing and the modernization of the U.S. dairy industry.

The bottom line is this: Federal dairy programs are not flexible enough to keep up with market innovation. And market innovation is what sells more milk.

Whether it is for a manufacturer, or a producer.

Now let me tell you about an area where we have done some innovation: in whey. "Necessity is truly the Mother of Invention;" in this case "innovation."

And there are two reasons why we moved into whey production: first and foremost, because there are no price regulations to restrict us.

Secondly, because there's a demand, and, we had ever increasing volumes.

Whey protein naturally makes up about 20 percent of the total protein in milk. Whey proteins are quickly and easily digested, can aid in weight loss or muscle gain, and they are easily dissolved in water.

Besides various dairy products and bakery products, whey proteins are used in nutritional supplements, meat bindings, and even those little film strips that freshen your breath.

In other words, whey proteins expand the utilization of milk. Through innovation, and through market development.

But price supports even have an impact on the whey business.

Government warehouses, through the price support program, offer the best return on non-fat dry milk. And when the government buys milk powder week after week, month after month, year after year at prices way above their market value, we're ensured surpluses hanging over the market.

Liquidating those surpluses—no matter how carefully it is attempted to be structured—hits the dairy protein market.

In 2002, the USDA started giving away surplus milk powder for livestock feed in drought areas. Guess what, the more powder that came out of government storage—even though it was supposed to go to livestock feed—the more prices in the whey market were undermined.

My point is this: the Federal Government is acting as a willing buyer and seller of dairy products, and it is disrupting the normal commercial markets.

And, it sure disrupts the normal commercial markets when the government sets up all different kinds of pricing rules.

Although Davisco is one company, with one bottom line, we have three plants that are forced to operate under three sets of rules in buying milk

- In Le Sueur, we buy milk from independent farmers, and operate inside the Federal milk marketing order. So we have to pay a minimum price under the order.
- In Lake Norden, South Dakota, we buy milk from a cooperative, who can originate milk under another set of unique rules—they are allowed to forward contract with producers. But get this, we are not allowed to forward contract with the coop.
- In Jerome, Idaho, we buy milk from independent farmers operating outside the Federal milk marketing order. We forward contract with them.

Three plants, three different sets of Federal rules about how we buy milk. If we were in the grain business, or the meat business, we wouldn't face that.

We also had an important business tool taken away from us by Congress just recently: forward contracting with all our suppliers. Which we still do in Idaho, and which we also did quite successfully in Minnesota.

Our program was a big success here in Minnesota. We don't have the ability to offer that service anymore because Congress let the Federal program that allowed us to forward contract expire. Being in the business as long as we have, we know a fair amount about the economics of milk.

We buy milk in three states: inside the order, outside of the order, and from a co-op.

My son Mitch, who runs a farm, has learned a lot about the economics of producing milk.

So, when Congress allowed independent dairy plants to forward contract with farmers from 2000–2004, his brother—my other son Jon . packaged together that knowledge as a service to our suppliers, and allowed them to forward contract their milk, and lock in a margin, just like farmers who supply a co-operative.

We really need to get back the opportunity to offer forward contracting inside the Federal order just like cooperatives do—because our producers are requesting it.

And Mr. Chairman, I thank you for your leadership on this issue.

Forward contracting is a fair, effective tool that allows both the producer and the handler to manage price volatility.

Producers can service debt, they can expand, they can guarantee a profit—you are not going to go out of business when you have locked in a profit on every gallon of milk.

Manufacturers can do the same things too, and by managing input costs they can dedicate some resources to product innovation and development.

Cash flow is "Business 101"—and that's what forward contracts help manage for both producer and manufacturer. That is why the cooperatives use it.

And that is why our suppliers outside the Federal Order system in Idaho use it.

You don't have to just take my word for it. USDA conducted a study on forward contracting during the pilot program period it was allowed: from late 2000 through 2004.

USDA concluded it was a good tool to reduce price volatility.

And most interestingly, . participation was highest where there was more than one buyer competing for milk.

Another example that the marketplace works. Competition works!

Our producers did not have to contract with us but if we were offering a competitive price, they did.

It is next to impossible to grow a business without tools like forward contracting—which are available to every business from supercomputers to jelly beans.

And today it is available to some dairy producers.

I'm not sure of the public policy goals of letting some producers use this tool, and not letting others use it.

To sum up this testimony, and a life time of experience in the dairy business, I want to sum up and underscore a few points:

- First, innovation and product development spell success in the dairy business.
- Second, current Federal dairy policy strangles and chokes out innovation and product development.
- Third, having two dairy subsidy programs is just plain crazy—there only needs to be one and it needs to get out of the way of markets.

Not a pretty picture, but the facts as I see them after nearly 50 years.

I want my sons and my grandchildren to have a future in this business, and I hope they can work with the sons and daughters and grandkids of our current suppliers—and new farmers who see an opportunity in dairying.

Because Davisco is not going to be making cheese and whey protein products if there is not a stable supply of milk,

But for all of our grandkids—manufacturer and producer— to have a future, we need to reform dairy policy. NOW.

The first step to real, equitable, and meaningful reform simply is not that complicated.

Just allow proprietary handlers and independent producers to enter into private, buy/sell, business contracts, that provide for cash forward sales.

All that would do is bring some fairness and business options to all producers and processors.

Locking in a profit is basic principle of economics, and fairness under the law it is a basic principal of America.

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## Statement of Bruce Maas

Mr. Chairman and members of the committee, I appreciate your invitation to present my views and those of the 4,000 dairy farmer members of Associated Milk

Producers Inc. (AMPI). My name is Bruce Maas and I am a dairy producer from Walnut Grove, MN., and a member of the AMPI Board of Directors.

As the owner of a family farm and stakeholder in a leading Midwest dairy cooperative, my perspective on the state of the Midwest dairy industry is drawn from more than 25 years of experience in this industry. Today I will share that perspective, providing a Midwest dairy industry snapshot, AMPI's policy priority for the 2007 farm bill and, finally, the competitive disadvantage shared by most of this region's dairy producers.

First, an industry snapshot. The picture has changed significantly in 25 years. There are fewer cows, fewer dairy producers and fewer manufacturing plants. This region has lost market share to our western counterparts. But don't think we're ready to board up parlors and plants. Though overall market share isn't growing, we're slowly reinvesting in our industry infrastructure.

A look at a picture of my family dairy reveals an image similar to many across the region. My wife Maydra and I have added a parlor, free-stall barn and more cows. Most important, our son Jared has joined the family farm. That's a sign we're optimistic about producing milk.

Our milk is manufactured into dairy products and marketed through AMPI. Our cooperative has closed a small number of our plants in the past 25 years, but added as much capacity to other facilities which enable us to make products with a higher dollar return.

As a producer, I'm willing to invest in my farm and dairy cooperative if there's an adequate dairy price safety net. Establishing that safety net is, in fact, AMPI's dairy policy priority for the 2007 Farm Bill. Let me share four ideas for crafting a strong safety net:

1. Increase the support price. The current $9.90 dairy support price is inadequate, unchanged since the 1980's.

2. Make it realistic. The USDA's Commodity Credit Corporation (CCC) must increase the milk price equivalent it's paying to remove dairy products from the open market. Because of increased manufacturing costs, the support program today gives dairy producers about $1 dollar less than Congress intended when enacting the support program.

3. Provide a countercyclical payment. AMPI and other members of the Midwest Dairy Coalition believe the Milk Income Loss Contract (MILC) is needed to further strengthen the overall safety net. The dairy price support program alone is inadequate and results in much less than the intended $9.90 level. When combining the MILC program with the dairy price support program, producers are supported on their first 2.4 million pounds of annual production.

4. Manage imports. The CCC shouldn't be buying the world's milk surplus. By closing trade loopholes, unrestricted dairy protein wouldn't enter the United States and displace domestically produced milk. AMPI has worked closely with the Midwest Dairy Coalition and the National Milk Producers Federation to close the loopholes through legislative action.

A strong safety net should not result in price enhancement, providing economic incentive for dairy producers to expand their businesses. It should prevent the collapse of milk prices to a level that can't financially sustain the operation of an average dairy farm. The dairy price support program should provide long-term, market-based income.

As Midwest dairy producers we don't expect special treatment. We just want a fair chance to walk the economic tight rope. To do that, we need a safety net and a level playing field with the rest of the dairy industry. Right now we don't have that.

There's a regional disadvantage shared by nearly all dairy producers in the Midwest and many who manufacture dairy products throughout the nation.

Since most Midwest milk marketing cooperatives take raw milk and manufacture it into products like cheese, butter and nonfat dry milk, we are dealing with rapidly rising energy costs. Though we're trimming energy expenses, there are factors we can't address on our own.

Under its Federal Milk Marketing Order system, the United States Department of Agriculture must increase the permitted manufacturing make allowance.

AMPI is one of several cooperatives that requested the January 2006 hearing to review make allowances in the Federal order Class III and IV formulas. The formulas continue to use data from 1998, which does not account for sharp increases in energy and other costs associated with manufacturing dairy products. As a result, the formulas place dairy product manufacturing cooperatives in financial peril and at a competitive disadvantage to those that sell most their milk into the fluid market.

Testimony presented at the January hearing overwhelmingly supported the need for emergency action on this issue. Increasing make allowances is crucial for the long-term economic health of cooperatives and their dairy farmer owners. If manufacturing cooperatives aren't profitable, this region's manufacturing infrastructure and producers' return on investment are at risk. With more than 85 percent of Midwest milk marketed through dairy cooperatives, this is a big deal.

We're still awaiting word from the USDA about how it will deal with this emergency request. This issue demands immediate attention and should not take a back seat to politics. Midwest milk manufacturing cooperatives are at a growing disadvantage.

As a producer and cooperative member, I fully understand the three points I've raised today are tightly intertwined. I hope today's committee hearing will engage policy makers and industry stakeholders in an important debate and discussion about the Midwest dairy industry, dairy price support structure and a regional disadvantage through the Federal order make allowances.

The challenge will be transforming today's words into ideas and action. Mr. Chairman, I want to thank the Committee for hosting this field hearing and allowing me to testify. I will be happy to answer any questions you might have.

## STATEMENT OF MARK CLARK

I wish to express my appreciation to Rep. Gutknecht and the members of the subcommittee for this opportunity to express my views on the state of the dairy industry in the upper Midwest. My name is Mark Clark. My son and I milk about 370 cows in the rolling hills near Rollingstone, Minnesota. I am a delegate in my dairy cooperative which is Land O'Lakes. As a delegate, I am elected by my neighbors to participate in the cooperative's governance system and represent their interests. I also have served on Land O'Lakes Policies & Resolutions Committee, which develops our cooperative's positions on public policy issues that affect dairy farmers, cooperatives, and the U.S. dairy industry.

Personally, I'm optimistic about the Upper Midwest dairy industry. We have a lot of built-in advantages in this region. We have good soils and we generally have ample rainfall, which means we're able to produce good crops of high-quality hay. Our close proximity to the grain-producing regions of the country provides us with ready access to feed ingredients. Historically, milk production has been a mainstay of farmers in this region.

Traditionally, milk produced in the Upper Midwest has primarily been used for processing, and in recent years, cheese has been our primary product. As a result, there's generally strong competition for the milk that's produced here. But as producers, we need to be careful that we don't become complacent and take our strong markets for granted.

While I'm generally optimistic, as Upper Midwest producers, we do face some challenges. Not all of these challenges can be solved by the Federal Government. But I do want to outline the challenges that I see because I think it's important for you to keep them in mind as you move forward with policy initiatives in Washington, DC.

One of the most difficult problems we face is market volatility. In recent years, we've seen milk prices fluctuate over a wide range. The peaks are higher than we used to see, and valleys are frighteningly low. We are just coming off of a period of very strong milk prices. During that period of time, we saw producers nationally expand their herds and increase productivity. Milk supply is up, and even though the economy is solid and demand is strong, the increased milk supply is depressing milk prices.

I don't think we're going to see a prolonged downturn in prices like we did in 2002–2003. But milk prices will go low enough to serve as a wake-up call to producers. We do have some tools that can help producers survive this period of low milk prices.

The Dairy Price Support Program has been the foundation of our national dairy policy for decades. It still plays an important role in providing a stabilizing influence when milk prices sink. But frankly, a $9.90 support price is not an adequate safety net. During the prolonged downturn of 2002–2003, when milk prices hovered near the support level for months, it became clearly evident that we cannot rely solely on the support price program to stabilize milk prices.

One of the most important things that's occurred since the passage of the last farm bill is that more and more producers are learning how to use the futures market to protect themselves from extreme price fluctuations. This has been a good educational experience for producers to gain some knowledge and experience about using risk management tools. To the extent that Congress may consider enhancing risk management as a strategy in the next farm bill, I think that dairy farmers will be much more knowledgeable in their evaluation of different approaches because of the experience we've had in the past several years.

Another component of the milk price safety net has been the Milk Income Loss Contract program. MILC has generated a lot of controversy since it was included in the last farm bill. My cooperative, Land O'Lakes, did support the extension of MILC through the end of the current farm bill. This was a decision that reflected a balance of interests of our co-op members, large and small, from one region to the next. While support for MILC has been controversial, for Upper Midwest producers, it has generally been a positive program. During the period of time that milk prices were extremely depressed, it provided producers with some breathing room to decide what to do about the future. To the extent that Congress may consider some kind of counter-cyclical payment as part of the dairy program, we certainly would urge following three basic principles—it should not discriminate between producers based on size; it should not discriminate between producers based on geography; and it should not result in distorting market signals or encourage production at a time when milk supply is excessive.

For many producers, one of the most exciting developments in the past few years has been the creation of the CWT program—Cooperatives Working Together. CWT is a modest attempt by the industry to exercise some degree of self-help. Through a voluntary, five-cent per hundredweight contribution, producers through our cooperatives have two tools for influencing market volatility. First, we can influence supply through a herd retirement program. Second, we can try to prevent supply from depressing markets through an export program. I'm very pleased that my cooperative, Land O'Lakes, is one of the largest participants in the CWT export program.

After two years of operation, producers are satisfied enough with the results of CWT to seriously consider increasing the program from a nickel to a dime. Land O'Lakes does support the increased commitment. We're realistic enough to admit that even at 10-cents per hundredweight, CWT will not be able to control extreme milk price volatility all by itself. But that's my real point. A $9.90 support price can't succeed by itself. Neither can risk management programs, and neither can MILC. As we look to the new farm bill and the future of dairy policy, it seems likely that the solution will require a combination of approaches. There likely won't be a 'one-size-fits-all' dairy program.

While price volatility is one of the most challenging problems that currently faces producers, from a Midwest perspective, one of the least visible problems that's emerging is the change in the dairy marketplace. I mentioned early in my statement that it's easy for Midwest producers to become complacent about our markets. But the indications are that the marketplace is changing.

In the Midwest, our milk plants are being squeezed on both ends. In order to keep the plant full and operate at efficient levels, our plants have to bid up the price of milk. But at some point, the marketplace will not sustain the price that our Midwest plants must pay. This is especially true because of the ability of manufacturing plants in other regions to procure milk at a lower cost than the Midwest. The symptom of this trend is when our Midwest manufacturing plants cannot operate at profitable levels.

For many years, California was the major source of competition for cheese and other manufactured dairy products. California still is a strong competitor. But we are seeing other regions emerge as even more intense competitors in the market for manufactured dairy products.

Last fall, Southwest Cheese Inc. began processing cheese at a huge new facility in New Mexico. And over the winter, Hilmar Cheese Co. announced plans to build a cheese facility in west Texas. Together, these two facilities, if ultimately developed to operate at planned capacity, would produce 15 percent of the American-style cheese in the country.

This will have a dramatic impact on our Upper Midwest cheese industry. Our plants are older and generally smaller. We will have a difficult time maintaining our market share with California, New Mexico, Texas and any other new, emerging region with rapidly growing milk supplies.

Part of the solution is a state and local concern. We have to adopt new policies at the state and local level that encourage the growth of milk production in the Upper Midwest. We have to redefine public attitudes about modern milk production practices to focus on creation of jobs and economic development. Minnesota and Wisconsin are trying hard to accomplish that task. Both states have either implemented, or are considering, new policies and incentives to reverse the trends and reinvigorate milk production in the Upper Midwest. If we are successful, then long term, I predict that we will see reinvestment in our milk processing industry as well.

But this will take time. Meanwhile, we have to adopt new strategies to sustain our Upper Midwest dairy industry while it grows. We must find ways to add value to existing milk production. This will require new, creative approaches to milk marketing. One promising approach is to encourage the production and marketing of specialty cheeses. Earlier this month, the Wisconsin Department of Agriculture, Trade, and Consumer Protection reported that Wisconsin leads the Nation in the production of specialty cheeses. If we cannot compete for the high-volume, commodity cheese market, we should be able to defend a niche market of producing high-value, specialty cheese.

The second strategy for sustaining Midwest milk producers is achieving greater efficiency within our dairy manufacturing infrastructure. Nationally, Cooperatives Working Together has been an effective self-help program for milk supply and export marketing. In the Midwest, we need a regional 'CWT' spirit of cooperation to eliminate duplication in milk procurement and transportation.

Finally, I believe there are opportunities for Midwest producers to supply fluid milk to the Class I market in areas where the local supply is inadequate. In many areas of the Northeast and Southeast, population growth limits the ability of the dairy industry to expand and meet local Class I needs. With modern transportation capabilities, we can feasibly service those markets from the Midwest more efficiently than from the Western states.

In order for this to work, the Federal milk marketing orders have to be flexible enough and adaptable enough to facilitate movement of milk to milk deficit regions. Our Midwest perspective is that we do not want to manipulate the milk marketing orders to the detriment of producers in the East or South. But we do want to be able to supply high-value Class I markets when the local supply is inadequate, and the milk marketing orders should not inhibit that from occurring.

At the beginning of my testimony, I said that I was basically optimistic about the future of the Midwest dairy industry. I believe we have the resources, experience, and capability to be a leader in our national dairy industry. But it will take hard work on the part of producers, cooperatives, and Federal policymakers to realize our full potential.

As lawmakers, we simply ask you to support public policies that give us a level playing field and the tools to help ourselves build a promising and prosperous future. Thank you for listening to my comments.

## Statement of Jim Green

Mr. Chairman and members of the Subcommittee, my name is Jim Green and I am the President & CEO of Kemps LLC, a Saint Paul-based company that makes and markets a wide variety of dairy products, including milk, ice cream, cottage cheese, sour cream, dips and yogurt. Kemps is a wholly-owned subsidiary of H.P. Hood, LLC, one of the largest dairy companies in America.

I have been in this business my entire life, starting with a family owned dairy operation in York, Pennsylvania. Today, I have the privilege of working at Kemps and chairing the International Dairy Foods Association (IDFA) and the International Ice Cream Association (IICA).

A lot has changed since 1914 when Kemps started making and delivering milk and ice cream. We now have 1,450 employees, most of whom work in five milk plants in Minnesota, South Dakota and Wisconsin, a cultured dairy products plant in Minnesota and two ice cream facilities in Minnesota and Connecticut.

Thank you for the opportunity to provide a Minnesota perspective on dairy policy as you plan to draft the next Farm Bill. The dairy industry faces some unique challenges in the Upper Midwest, but we share a national belief that America has the best dairy industry in the world.

Nationally, our farmers produce an abundant and growing supply of milk and our healthy dairy processing sector makes foods and beverages enjoyed around the globe. But, if our present set of dairy policies is left unchanged, then our ability to be competitive here in Minnesota and abroad will be diminished greatly.

As we approach the next Farm Bill, now is the right time to have a serious discussion about the need to strip away outdated farm policies and put in place programs that promote innovation and growth.

While others on this panel will undoubtedly focus on the urgent need to address problems with our costly and complicated dairy subsidy programs, I would like to focus first on the Federal Milk Marketing Order program and then suggest to you guiding principles that can be used when you write the next Farm Bill to bring common sense to the maze of our dairy regulations.

In many respects, classified pricing is at the root of many of the industry's problems, particularly in this part of the country.

The milk marketing program has been around since the Great Depression—nearly as long as Kemps. Since then, my company and other dairy processors like us have modernized our operations to take advantage of advances in refrigeration, distribution, telecommunications and other business innovations.

Unfortunately, the Federal milk marketing order system has not kept pace with the demands of a changing dairy industry. Just as it did decades ago, the Federal Government still sets the base price of milk that Kemps and other processors must pay to cooperatives and dairy farmers.

The government still operates a complex system of pricing milk based on how the milk is used, with higher prices paid for milk used for beverages (Class I) and successively lower prices for milk used in yogurt, ice cream, soft products (Class II), cheese (Class III) and butter and dry milk products (Class IV). Regulated milk prices are different, too, based on "where" the milk is used—not just what products the milk is used in.

The complexity and stagnation of the Federal milk marketing orders, which are unlike any other commodity program, have created a system of milk price regulation that often stands in the way of milk moving to its highest value use from the most efficient production areas. As a result, we have a system that causes regional price distortions and has grown so cumbersome that even the simplest changes take years to make.

In Minnesota, where our milk supply has been declining steadily, these regional price concerns raise serious long-term questions of sustainability and fairness for dairy farming and processing.

The Federal milk marketing orders keep us at a competitive disadvantage in today's marketplace. Seventy years ago, milk was unrivaled as the beverage of choice for American consumers. Today, milk competes directly with bottled water, fruit juices and soft drinks, none of which are subject to government-run classified pricing schemes. Globally, only America and Canada still maintain rigid milk price setting regulations while our competitors, like New Zealand and Australia, have no such regulations. Even emerging international dairy markets, such as Russia, China and India have avoided the "American model." Ironically, these socialist countries have freer dairy markets than we do. These are all clear indications that we need to change the way we do business in America.

Beyond the complex web of Federal milk marketing orders, the U.S. has two countervailing dairy subsidy programs that USDA found in 2004 do very little to help dairy farmers. The Milk Income Loss Contract Program (MILC) and the dairy price support program are at odds with one another. MILC stimulates over production, depressing prices and causing greater price instability in the market place. While the dairy price support program makes the government an active, willing buyer of dairy products—preventing markets from clearing properly when products are too plentiful and artificially interfering with the commercial marketplace.

The Federal Government also spends billions of dollars on a host of beneficial conservation and animal health programs, disaster relief efforts and rural development that are all designed to assist our farmers, including dairy farmers. All of these programs should be examined carefully and only the ones that stimulate growth and innovation should remain.

Unfortunately, we cannot fix all of the problems with Federal dairy policies that have accumulated over the last seventy years. However, we can take small, meaningful steps that will put us on the right track to future success. We can make the Federal milk marketing order process more flexible and responsive. We can initiate a transition from multiple, divisive and costly subsidy programs to a single, national dairy farmer safety net. We can create a more level playing field for all producers and processors to compete fairly and equitably. The next Farm Bill provides an historic opportunity for Congress to begin this process to ensure that the U.S. dairy industry will be more prosperous in the future.

We can accomplish all of these goals if we work together and come to a consensus on the basic principles for a more modern, market-oriented set of national dairy policies.

First, it is important that policies allow market signals to work so that our products can be the most cost competitive and innovative in bringing consumers what they want and will buy.

Second, while there are certainly regional differences in our industry structure, it is important that Federal dairy policies be national in scope, recognizing national and even global markets for our products.

Third, policies should be designed to allow market signals to operate naturally and minimize Federal Government expenditures.

Fourth, there should be a single, national program to provide a safety net for dairy farmers that minimizes market interferences as much as possible, is consistent with our trade objectives and policies, and yet still provides critical assistance when it is needed.

The dairy processing industry is committed to these principles and believe they are the foundation for our future; providing producers and processors the greatest opportunity for strong growth and prosperity.

I commend you for holding this hearing and gathering a diverse group of dairy industry representatives together to share our ideas. The outcome of the farm bill is important to my business, important to Minnesota, and important to the ultimate success of the U.S. dairy industry.

## Statement of Gordon Crow

Thank you, Mr. Chairman and members of the committee. My name is Gordon Crow. I am the director of government and community affairs for The Schwan Food Company based in Marshall, Minnesota. I want to thank the Chairman (Mr. Gutknecht) for holding this timely hearing in Minnesota and inviting Schwan to testify on the many important dairy policy issues affecting the industry today.

The story of Schwan exemplifies the spirit of American entrepreneurship. Marvin Schwan started selling and delivering ice cream to rural homes in Southwest Minnesota-about 300 miles west of here-in March of 1952, out of the back of a dilapidated 1946 Dodge panel van. At the time, Mr. Schwan and his parents ran a small dairy that was-ironically-struggling due to government price controls on milk.

Today, The Schwan Food Company is one of the largest branded frozen food companies in the world. It is a multi-billion dollar, international corporation, with major manufacturing operations in eight states, and three countries in Europe. Schwan employs about 22,000 people worldwide. Our brands can be found in more than 50 countries. Schwan products can be found in homes, supermarkets, convenience stores, public and private schools, military dining facilities, hospitals, universities, and many restaurants and entertainment venues. Seven out of 10 school lunchrooms carry our products, and about three-quarters of the frozen pies sold in America are manufactured by Schwan. It is reasonable to assert that Schwan is a local company that competes in a global market.

Mr. Chairman, as you know, the Federal dairy policy rules of today were laid out before Schwan; before interstate highways; before dependable refrigerated hauling. Most of the policies under which we labor today were created during the Great Depression, when the factors of trade in America and, needless to say internationally, were dramatically different. A tremendous opportunity exists for the U.S. dairy industry in today's marketplace. While I do not buy and sell commodities for Schwan, I have consulted with our commodity group and can tell you, in order to take advantage of this opportunity, we must look to the vast number of other commodities that are succeeding without layers of subsidies. We must adopt a coordinated Federal dairy policy that is flexible, market-oriented, and environmentally sound.

Let me illustrate my point. At Schwan, frozen pizza is one of our signature products. To make pizza, you need dough, sauce, cheese and toppings. I'm here to tell you that none of the other industries we deal with in the making of frozen pizzas face the same challenges as the dairy industry.

The Government does not tell the flour mill from which we buy product what they must pay their wheat farmers, or the tomato paste manufacturer what it must pay tomato farmers for their perishable product, or the pepperoni company what it must pay the beef rancher. Equally confounding, with each of these ingredient providers, we have the opportunity to contract for a specific amount of product at mutually agreed upon, fair price. We are prohibited from forward contracting for our dairy ingredients based on the unfounded fear that dairy farmers would in some way be harmed if we were allowed to voluntarily negotiate a fair price for the dairy products we buy.

No other commodity has regulated prices like dairy. Wheat growers—and other program crops, for that matter—have a safety net that allows them to preserve farmer income while at the same time clearing the market of surplus. Tomato producers do not have a Federal safety net program. They rely on forward contracting ... and it is working well for them. Moreover, cattlemen, free from the restrictions of dairy-like pricing regulations, have been, and continue to, develop a variety of products that the consumer wants: whether it is lean beef, naturally produced, certified Angus, aged beef, guaranteed tender, or so forth.

My point is Congress needs to take action by overhauling our current dairy policy so that companies like Schwan can remain competitive in local, national and international markets. While a lot has changed since the 1950's at Schwan, the same cannot be said for the policies and regulations for milk and dairy products, which have our markets in a stranglehold.

Let me suggest that a new policy direction for dairy should address two key changes from the current antiquated system.

First, we need to change existing subsidy programs that weigh us down. As you have heard in testimony from across the country, the Milk Income Loss Contract (MILC) and dairy price support programs simply work against each other. They create a heavy financial burden for our government and interfere in the marketplace. In fact, as many have expressed, these inefficient programs work at cross-purposes and distort dairy market signals. We need to make sure that any new system affords assistance to the entire dairy industry while letting markets dictate production. Mr. Chairman, Schwan supports the existence of a safety net for dairy farmers. But, one that allows markets to operate unobstructed while still providing critical support for farmers. We cannot continue to suffer under two conflicting subsidy programs like the wheat industry did years ago.

Second, we need to open dairy markets at home and abroad. Trade restrictions on items such as milk protein concentrates, caseins and caseinates, or import assessments on similar products are simply bad ideas from the past. There are companies now making these highly refined dairy proteins in this country every day and, I might add, doing so successfully without having to rely on support programs, government subsidies or regulated minimum prices. And, restricting access to imported ingredients hurts our trade credibility, and our Minnesota businesses. American policy must set the standard for increased market access and efficient production ... both at home and abroad.

The Federal dairy price support program is the main reason that the U.S. is not a world leader in the production of value-added dairy proteins because the program makes it more profitable for companies to sell nonfat dry milk powder to USDA than to invest in technology to make milk proteins demanded by the market. I know you are familiar, Mr. Chairman, with the International Trade Commission report that concluded that U.S. production of specialized milk proteins is "limited, and likely to remain limited, so long as the current Federal Milk Marketing Order and Dairy Price Support Program remain in effect." The market needs these proteins, and we need these proteins for our dairy industry to grow, so it is up to Congress to reduce the policy obstacles, which stand in the way.

America's dairy industry must maintain its strong global position. In fact, the combination of the Doha Development Agenda in the WTO, U.S. free trade agreements and the Farm Bill renewal process are all aligned to provide us an historic opportunity. We now sit on the verge of arguably the best opportunity we have had in decades to get our policy cards put together in a way that gives the U.S. the best hand at the table among major dairy producers in the world. We must not waste it. We should also not sit in a defensive policy crouch, blame others, and squander this chance to build a better policy platform that encourages our already enormous efficiencies and resources to grow even more. However, Mr. Chairman, with or without an agreement out of Doha, it is imperative that we remain committed, as a nation, to see that commerce, not government regulations, guide the investment and production decisions companies like Schwan make every day.

Mr. Chairman, The Schwan Food Company prides itself on making products with the highest quality dairy ingredients. It is a pride that can be shared by all American dairy farmers. Farmers and processors are involved collaboratively in today's business environment and we must do the same on policies. Let us work together to maintain that standard of quality and address these pressing issues. I am confident we can rise to the challenge so that our next generation of Schwan employees worldwide can continue the rich tradition established by Marvin Schwan fifty-four years ago. Schwan and the dairy industry stand ready to help you in this endeavor.

Again, thank you for the opportunity to testify today. I look forward to your questions.

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## Statement of John Vrieze

Mr. Chairman and members of the Committee, thank you for inviting me to join this distinguished group of dairy experts and industry leaders as you and your colleagues in Washington prepare to consider reauthorization of the 2002 Farm Bill. My name is John Vrieze. I am the President of the 400 member Wisconsin Dairy

Business Association. I am also a third-generation dairy farmer from Emerald, Wisconsin were I milk nearly 3,000 cows.

I would like to accomplish these things during my brief testimony. First, I would like to introduce you to the Wisconsin Dairy Business Association. Secondly, I will offer a general reaction to the many flaws in our existing portfolio of Federal dairy programs. I will conclude my presentation by sharing with you some recommendations as you begin to develop the next dairy title of the new farm bill.

The Wisconsin Dairy Business Association was created in 2000 to provide a louder voice for the dairy farm families, processing entities, cooperatives, agricultural lenders, and rural leaders who believe in growing and modernizing the Wisconsin Dairy Industry. As one of the co-founders of the organization, I am particularly proud of the great depth and breadth of our membership. As our name indicates, we are truly an organization that represents all aspects of the dairy business sector. Since inception, DBA has focused a tremendous amount of effort towards ensuring state legislation and regulations help drive competitiveness and include common sense approaches to positioning our dairy families to compete in the national and international market.

Our organization worked with the Wisconsin legislature to pass a series of key measures all of which are geared towards ensuring our state and region are positioned to be competitive and viable well into the future. Specifically, we worked to pass a Dairy Investment Tax Credit program that has helped generate more than $120 million in new investments made by dairy farmers—helping to ensure their operations are modern, efficient, and competitive. Recently, we worked with the legislature to adopt a landmark livestock-siting bill that provides a common-sense roadmap for producers and local officials looking to expand livestock operations. This legislation will no doubt be the model for other states as they struggle with inconsistent zoning requirements and the difficult task of balancing the demands of various land-use planners.

Because we recognize that the dairy industry is increasingly changing and becoming a greater national and international market, DBA has decided that it is time to become active contributors to the dialogue involving existing and new Federal programs. We do not pretend to have all the answers, or believe we can solve all the problems facing the industry. However, we do believe we can offer a lot to the discussion and this hearing is one excellent way to begin the conversation.

Today's U.S. Federal dairy policy is far from perfect. In fact, I would say only a handful of dairy producers here in this room actually completely understand how our milk is priced. Class one differentials, make-allowances, butter-powder tilts, and the list goes on may make sense to my good friend Dr. Bob Cropp and the hard working USDA employees and economists. However, I am pretty sure you would be hard pressed to find a dozen dairy producers who can explain the system to you. Not only is our current system cumbersome and complex, but the current composition and layers of policies actually prohibits us from properly responding to true market demands and signals.

The core component of our milk pricing system, the Federal milk marketing order system, is a hodgepodge of outdated rules and regulations that have divided the major milk producing regions of our country for years. A four class pricing system, combined with various pricing differentials and complex blend price formula's have long outlived the original purpose of making sure Americans had access to enough bottled milk. The existing structure has stifled the innovation and market creativity we need to carry this industry forward. Given the makeup of the order system, milk is not being produced where it can be done most efficiently, and to make matters worse the classified pricing structure is preventing milk from flowing into products that have the highest value and greatest consumer demand.

The order system, with the various amendments which have been passed over the years have encouraged not true competition or innovation but rather bureaucratic paper pooling practices that serve no function in the market place. Making matters worse, and this is in no way a criticism to the hard working, professional and responsive USDA employees—but taxpayers and dairy producers alike are being asked to support this structure through assessments, and in some cases increased prices on the shelf.

Rather than learn new gimmicks to outsmart the order system, our industry leaders, and those who you have asked to testify here this morning should be tackling the many vital issues facing our industry like decreased demand and an alarming increase in competition with other beverage choices like soft drinks. Our marketing experts and product developers need to explore new uses of milk products and we need a true national strategy to ensure we can compete on the world market.

I would also like to make a few comments about the existing dairy price support program. While I know I may not make new friends out west with these comments, I do believe many of my friends would agree that the existing price support program needs a major overhaul, if not complete elimination. Although originally designed to assist the industry during periods of extremely low-prices, this program has actually created a small segment of our industry that simply produces milk powder, regardless of true market needs, and sells that product to the Federal Government at a cost to all of us in this room. As I will explain a bit later in my presentation, milk price volatility does justify the need for a reasonable safety net. However, the existing purchase program does not succeed at strengthening our ability to compete and make a living—at a minimum the annual USDA expenditure to administer the program, purchase product and store it in inventory does not equate, in my opinion, to any meaningful level of support for the dairy producers here in the upper Midwest.

Next, I would like to take a few minutes to briefly lay-out some of my suggestions for future dairy policy initiatives that properly positions not only the upper Midwest —but also allows for my fellow dairymen around the country to make a decent living at milking cows.

While dairy industry leaders in other regions disagree on lots of specifics, I think we can all agree that it is time to reinvigorate rural economies by ensuring the best and brightest among us have opportunities to return to their home communities and carry on our legacy of hard work and success. I would argue that while our government should not and cannot afford to guarantee the cost of production, it certainly has a responsibility to make sure that existing programs in place are not operating as hurdles to our ability to remain profitable.

Along those lines, I suggest four specific priorities that must be addressed by Congress to help reenergize the dairy industry and thus our rural communities.

First, the government needs to eliminate the outdated and antiquated Federal milk marketing order system. A new and simplified pricing structure needs to be phased in as a replacement for the many reasons I explained earlier.

Secondly, new and expanded risk management tools like permanent forward contracting must be expanded to all producers regardless if they ship their milk to proprietary or cooperative owned processing plants. Extreme volatility and extended periods of low prices call for this risk management tool to be made available to all dairy producers—similar to the tools made available to farmers who grow other commodities.

Third, Congress needs to phase out the existing dairy price support program and replace it with a new program that encourages the domestic production of milk protein concentrates and other dairy products that are in high demand. There is no reason why U.S. producers shouldn't be providing the raw ingredients for this product, rather than turning to increased importation to meet consumer demand.

Fourth, we need a sensible counter-cyclical program that treats all operations, regardless of size and location, fairly. While the existing MILC program has been a lifeline for many of the farm families in Wisconsin, we should not expect that level of assistance to keep us in business. In fact, increasing budget constraints and international trade pressures may not allow for it to continue. However, we do need a sensible program, and a reasonable level of support that is only triggered during extended periods of depressed prices.

Finally, Congress must make every effort to bring California into a new national program. We can no longer allow America's largest dairy producing state to be insulated with its own pricing structure. I know that there are plenty of producers in California who would like to explore the possibility of forming a new national pricing system, while also dealing with some of their unique concerns related to milk solids and issues surrounding the quota system. I think it is time to begin negotiations with California to see if we can come up with a program that allows both regions to prosper—I know it is a tall order, but we need to exhaust all options to see if we can move beyond the pitting of one region against another.

The suggestions I have just explained are meant to be guiding principles for you to consider. All of us in this room are keenly aware of how difficult it can be for you to balance the regional nature of our industry. However, it is my hope that this Committee will continue to work with not only producers from this region, but from all over the U.S. to craft a forward-thinking and modern dairy policy that benefits the entire industry.

Please know that my organization stands ready to assist you and your colleagues as you attempt to craft the next dairy title of the new farm bill. I will be happy to answer any questions you may have.

## STATEMENT WILLIAM C. BRUINS

Mr. Chairman, members of the subcommittee:

My name is Bill Bruins and I serve as president of the Wisconsin Farm Bureau Federation. I farm in partnership with my brother and two sons. Our dairy farm has 600 milking cows with 1,100 acres. We are members of Alto Dairy Cooperative.

On the behalf of the Wisconsin Farm Bureau Federation, I am pleased to provide comments on the dairy industry in Wisconsin but more importantly make some observations with respect to crafting future Federal dairy policy which is one of your subcommittee's responsibilities.

In Wisconsin, we are making strides to keep our dairy industry competitive by advancing several state initiatives which include a dairy investment tax credit, recent legislation and rules to site new and expanding dairy operations and grant programs for innovative ideas.

In his testimony, Dr. Bob Cropp of the University of Wisconsin-Madison provided the subcommittee with an excellent analysis of laying out the trends with in the Wisconsin dairy industry with respect to the number of dairy farms and the number of head per farm. I agree with his assumptions. We will have fewer, larger dairy farms. However, our strong family farm heritage among other things will ensure that Wisconsin has farms of all sizes.

We have a unique situation in then Upper Midwest as well. Normally, competition for milk is a good thing for dairy farmers. But right now with relatively flat milk production, our manufacturing plants are paying more for milk than their counterparts predominantly in the West. In the short term it has been great for dairy farmers but over the time this will deteriorate our manufacturing infrastructure. The dairy industry through the Federal order hearing process needs to be able to more quickly be able to change the "make allowance" to help our dairy cooperatives compete in a national market. Specifically, the dairy industry needs to be able to vote on any change to a Federal order without voting out an order. Further, USDA needs to speed up its entire hearing process.

With respect to Federal dairy policy, the WFBF has been a long-time proponent of removing regional inequities and having the U.S. dairy industry become more market orientated.

The price support program, which has been touted for years as an effective safety net, no longer serves that purpose for several reasons. First, the price support program does not provide a true floor price. For example in 2000, the Class III price was below the $9.90 support price for seven months. In 2002, the Class III price was under support for three months and in 2003, the Class III price was less than support for six months. This demonstrates that the $9.90 support price is too low and not an effective safety net. Some, especially those making cheese may say that the support price is too low and needs to be raised to make the price support program once again an "effective" safety. The only thing raising the support price will do is trigger the over production of milk and the subsequent purchase of dairy products by the Federal Government.

Further, because of changes in the way we manufacture and market cheese, the price support program and Commodity Credit Corporation (CCC) purchase program are not as valuable as it once was to the Upper Midwest Dairy industry. I view this as a great improvement—we are making cheese for the market and not for the Federal Government.

Over the last for or five years, when there has been purchases by the CCC they have been in the form of nonfat dry milk. Rather than selling nonfat dry milk to the CCC, I would much rather see our manufacturing plants producing a higher value product like Milk Protein Concentrates (MPCs). Incentives to produce MPCs would be beneficial to farmers and the dairy industry for years to come.

In the future, the WFBF believes the Milk Income Loss Contract (MILC) program or a similar counter cyclical program is the best option to provide dairy farmers with an "effective safety net" when prices are low because it provides a true price floor. If we could properly structure a counter cyclical program we could eliminate our current price support program and get the Federal Government out of the business of purchasing surplus dairy products. The government never consumes the product—it just waits a while before it dumps the product on the market.

The WFBF has been a long time supporter of a counter cyclical program for dairy farmers. In fact, the WFBF has advocated this approach more than 20 years ago when then 1985 Farm Bill was being discussed. At that time, the idea did not get much traction, but times have changed. The dairy industry is no longer a just a domestic industry. The world market influences prices more than ever before.

American Farm Bureau Federation policy supports "a market -orientated national dairy program that includes a national counter cyclical income assistance component, such as the Milk Income Loss Contract program, which is consistent with a worldwide fair and open trade policy.”

In March 2005 paper entitled “Dairy Policy in the Next Farm Bill: An Early Assessment,” Professor Ed Jesse, a dairy economists from the University of Wisconsin, pointed out that:

”Using a target price of $10.50 per hundredweight and paying 100 percent of the deficiency relative to the Class III price on all milk would have yielded a total program cost of $1.4 billion since MILC began in December 2001 through February 2005. In other words, an unconstrained counter cyclical payment program with a target price $0.60 higher than the current support price would have cost 70 percent of the $2.0 billion cost of MILC.”

Knowing that Congress would most likely put in place payment limitations, the WFBF believes the payment limitation system that is used for other commodities would work very well because farmers understand how it works and it could minimize current objections to the volume cap that is part of the MILC program.

The WFBF strongly supports MILC, however, in his paper, Dr. Jesse also pointed out that the current MILC target price has been too high compared to average prices for milk over the last few years, which makes the program income-enhancing causing larger per hundredweight payments and large program costs. Any counter cyclical program needs to be a safety net and not a price guarantee.

Lastly, trade issues will have a major impact on what provisions are in our next Farm Bill. Countries around the world are asking the United States and other countries to reduce their subsidies. As you know, Farm Bureau has historically supported expanded trade opportunities. The WFBF believes a counter cyclical payment program for the dairy industry, while still an amber box (trade distorting) program under the World Trade Organization would cost less and be more accepted worldwide.

Currently, the WTO allows the United States $19.1 billion in amber box payments. Using WTO calculations, the dairy price support program contributes $4.5 billion. The $4.5 billion is determined by taking the difference of the $9.90 support price and a world reference price of $7.25 multiplied by total United States milk production. It is important to know that while the $4.5 billion counts against the U.S. in trade negotiations, very few of those dollars ever get into dairy farmers' pockets.

Again, a counter cyclical program could be operated at less cost than the current price support program and provide and effective safety net to farmers.

Lastly, I would like to make comments on a couple other areas that affect Federal dairy policy.

The Cooperatives Working Together (CWT) program, a checkoff program initiated by the dairy industry has some positive effect on milk prices. The WFBF supports this program however we would like the program to focus more on developing export markets rather than herd retirement.

With respect to the Federal Milk Marketing Order system, the Upper Midwest has called for major reform for years. The FMMO is antiquated system that works in conjunction with the price support program to determine prices around the country. The program worked great years ago when the majority of manufacturing milk was produced in Wisconsin and Minnesota. While we are still major players, milk production has shifted to the West. The FMMO system has not kept up with the changes. The WFBF believes that Federal milk marketing orders around the country need to be consolidated into a single national order to minimize regionalism and eliminate pooling issues.

Thank you for the opportunity to make a few observations with respect to future Federal dairy policy. The dairy industry has a great opportunity to move forward to a more market orientated approach that will be good for dairy farmers and processors in the long run.

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## Statement of Gene Hugoson

On behalf of Governor Tim Pawlenty and Minnesota's 5,000 dairy farmers, I want to thank Congressman Gil Gutknecht and Congressman Collin Peterson and the sub-committee members for coming to southeastern Minnesota to examine important questions about the future of the nation's dairy policy.

Dairy production is a key part of Minnesota's economy. In a typical year, cash receipts from dairy production surpass $1 billion—12 percent of the total value of the state's agricultural production. The total economic impact of Minnesota's dairy production and processing industries is $10.8 billion, and each dairy cow generates nearly $5,000 in economic activity.

The total employment impact of Minnesota's dairy production and processing industries is estimated to be 76,590 jobs. This employment figure includes direct employment of 6,111 jobs in dairy production, and indirect or induced employment of another 21,291 jobs. Dairy processing, meanwhile, has an estimated direct employment impact of 8,646 jobs and an indirect or induced employment of 40,541.

While dairy production is the second largest economic contributor among Minnesota's livestock categories, it is also posting the weakest performance among the state's livestock sectors. Minnesota's share of national milk production dropped from 7 percent in 1980 to below 5 percent in 2005. Milk cow numbers dropped 31 percent from 1992 to 2005, and the state's annual milk production fell 17 percent in that same period.

Much of the nation's milk production is shifting to western states. For example, from 2000 to 2005, California added 229,000 dairy cows and 5.3 billion pounds of milk production. Idaho added 108,000 cows and 3 billion pounds of production. In the same time, Minnesota lost 81,000 cows and 1.3 billion pounds of production.

The struggles of the Upper Midwest dairy industry raise long-term concerns. The processing and production facets of the industry are at risk of becoming obsolete in comparison to other states. As a result of these trends, producers and processors may hesitate to reinvest at a time when such activity is needed.

As input costs have increased and commodity prices have lagged, profit margins for farmers have shrunk. This has driven some Minnesota dairy farmers out of business, while others have chosen to farm part-time and work off the farm to supplement their farm income. Some have chosen to switch to alternative business models such as organic production or on-farm processing. For others, the approach has been to try to increase

the number of animals to offset the declining per-unit returns. As profit margins tighten and the costs of operating a business and supporting a family increase, some farmers find they need to modernize and increase their efficiency simply to generate a livable income.

Regardless of which approach is taken, there are opportunities for success in Minnesota's dairy industry when farmers are given the flexibility and freedom to choose which business model best fits their needs and goals. However, attempts to expand or improve their facilities are sometimes met with resistance. In communities around the state, producers are increasingly faced with environmental and social pressures that impact their operation. Public concerns about the environmental and social impacts of modern animal agriculture have led to more stringent environmental rules and higher compliance costs for producers. Unfortunately, these public concerns are too often based on misperceptions or misinformation. Nonetheless, these pressures are constraining production growth and limiting investment. They can also erode a farmer's desire to continue in the business.

In recognition of these challenges, Minnesota Governor Tim Pawlenty created a Livestock Advisory Task Force to evaluate the status of Minnesota's animal agriculture industry and make recommendations to support its retention and growth.

The 14-member task force included three representatives from the state's dairy industry, as well as agricultural finance, producer organizations, academia, state government and other livestock sectors. Task force members issued a report in July 2004 that included recommendations in areas such as local siting of livestock facilities, permitting of facilities, improving farmers' access to investment capital, and odor mitigation research. Progress has been made in several of these areas, but more work needs to be done.

Despite its many challenges, Minnesota's dairy industry does enjoy several competitive advantages over producers in other parts of the country. These advantages include a diversity of farm size and structure, less expensive feed, readily available water, temperate summers, and a strong dairy infrastructure. Also, the growth of Minnesota's renewable fuels industry benefits dairy producers in a number of ways. For example, dried distillers grains, a co-product of the ethanol production process, provide a valuable source of relatively inexpensive, high-quality feed for dairy cows. New renewable energy technologies pioneered in Minnesota, such as methane digesters, help reduce farmers' energy costs and create new revenue streams through the sale of electricity and carbon credits.

There are also promising developments with regard to international markets. The economic growth in Asia and Latin America has led to important new export opportunities for dairy farmers in Minnesota and other states. According to information from the U.S. Dairy Export Council (DEC), almost one of every three new pounds of milk solids produced in 2005 was sold to overseas markets. Also, DEC reports that U.S. dairy exports increased 13 percent from 1.6 billion pounds in 2004 to 1.8 billion pounds in 2005. U.S. dairy imports increased only 4 percent in that time. Dairy exports in 2005 equaled 8.3 percent of overall U.S. production.

Perhaps the most important strength for Minnesota's dairy industry is the enthusiasm and creativity of its next generation of farmers. These bright, enterprising people want to be their own boss. They want to avoid a stifling office environment. They love the beauty of the Minnesota landscape. They see an opportunity to raise their kids the way they were raised. Above all, they believe there are still ways to milk cows and support a family with a reasonably good income.

Greg Sabolik and his wife, Marisa, got into the dairy business six years ago and today they milk 70 cows in Douglas County. Sabolik said he had a chance to try life off the farm, and it wasn't for him.

"I got a degree in engineering and a job right out of college, but I always knew I wanted to come back and farm," Sabolik said. "I love what I do."

While many of the issues facing Minnesota's dairy industry must be addressed at the state and local level, there is still a need for effective and fair Federal dairy policies as well. For example, Minnesota has long advocated for reform of the Federal milk marketing order system to correct imbalances and market distortions that put our producers at a disadvantage. With recent changes in the marketplace, as well as the upcoming farm bill debate and the influence of the World Trade Organization (WTO) discussions, I suggest that now is the time for the Federal Government to move the nation's dairy policy from the early 20th century to the 21st century. After all, the foundation for our current dairy policy was set in a time before interstate highways, jet airplanes or even television. So much has changed in the way we move products and information, and in the way our markets work that we no longer can afford to be saddled with such a cumbersome and convoluted dairy policy.

As you undertake the next Federal farm bill, I would like to submit the following observations.

## Dairy Programs

Minnesota has benefited from the Milk Income Loss Contract (MILC) program, taking in more in payments than all but three other states. Congress should examine whether the $9.90 price support system and corresponding market distorting government Commodity Credit Corporation (CCC) purchases of products should be reduced or eliminated in exchange for an expanded MILC program. Consideration should be given to the questions of whether there is a modern-day rationale for CCC purchases and whether the market, through cooperative and private processing sectors, can process increased milk supplies, and market or store the corresponding products without that program. This issue is especially important when you consider that a significant portion of America's U.S. World Trade Organization (WTO) "amber box" limits are taken up by current dairy price support programs.

The National Association of State Departments of Agriculture (NASDA) has been advocating the creation of Partnership Agreements to help states leverage Federal dollars to meet the unique needs and challenges of their agricultural industries. These partnership agreements would have the added benefit of not counting against the U.S. amber box calculations since they would not tied to production.

One example of how this might benefit Minnesota dairy farmers can be seen in the Minnesota Department of Agriculture's Dairy Development and Profitability Program. Through this program, the state provides $1 million a year to help farmers improve their on-farm efficiency and modernize their facilities. Given the importance of farmers' profitability and efficiency in today's hyper-competitive environment, it is likely that a Federal program in partnership with and leveraging Minnesota's program could have a widespread, positive impact on farmers who want to remain in dairy production but are at risk due to inadequate facilities or inefficient operations.

I also suggest that Congress examine whether, given the significant changes in the marketplace for dairy products in recent years, it is possible that the current price-support system inadvertently encourages production of products with limited demand while at the same time taking away producers' and processors' focus from products with growth potential. There is a limited market for non-fat dried milk, especially in the all-important export markets. We need to make sure that the Federal dairy program does not stifle marketplace innovation.

Finally, with regard to Federal dairy policy as a whole, I believe Congress should examine whether our country should continue to operate under an antiquated Federal milk marketing order system when our transportation infrastructure has modernized to allow fluid milk to travel hundred of miles within hours.

Conservation Provisions

As you look at re-authorizing components of the conservation title within the upcoming Farm Bill, I encourage you to devote adequate resources to the Environmental Quality Incentives Program (EQIP) as it relates to dairy producers. EQIP has been a valuable program for Minnesota's dairy producers, who continue to work hard to comply with a myriad of local, state and Federal laws, rules and regulations. In my experience, most Minnesota dairy farmers are eager to help conserve our natural resources, and will take advantage of opportunities to do so when they can.

One specific facet of EQIP I encourage you to examine is inequities in funding in cost-share rates for dairy operations. The U.S. Department of Agriculture's Natural Resources Conservation Service should strive to provide equitable cost-share funding within similar regions of the Nation for all types of dairy operations, regardless of size or type of dairy system.

I suggest that Congress also explore how a revamped Conservation Security Program (CSP) may be of particular benefit to dairy producers and their operations. A program like CSP offers hope that dairy operations will be given the opportunity to receive incentive payments for raising forage crops, which are mutually beneficial to livestock and the environment.

### Risk Management

With farmers continuing to struggle with the peaks and valleys inherent in milk prices, there is greater need than ever for our farmers to have solid risk-management tools. Tools such as livestock revenue insurance and whole-farm revenue insurance can help farmers manage price and production risk.

### Addressing Structural Dairy Policy Issues in Next Farm Bill

Regional controversies and inequalities have permeated dairy discussions for decades, and at times a solution to these problems has seemed beyond the reach of policy makers. However, I believe for the benefit of the entire dairy sector, the time has come for Congress to tackle fundamental issues that have led to confusion and acrimony. Our nation's dairy producers deserve a Federal dairy policy that has uniformity, clarity and credibility in all regions of the country.

We must confront how future dairy policy will interact with the transforming market place, the Federal budget and our WTO obligations related to limiting trade-distorting spending. Currently, of our $19 billion WTO spending cap, nearly $5 billion is dedicated to dairy spending. With several WTO proposals on the table to reduce overall spending, and feared challenges, it is naive to hope that dairy policy and its corresponding spending can escape discussion. Ultimately, the goal of Federal dairy policy should be to assist the nation's dairy farmers in managing the risks associated with competing in a global economy and ensuring that policies don't distort market signals or result in regional disparities among our dairy producers.

Thank you for the opportunity to provide comments to your committee, and for your efforts and hard work on behalf of Minnesota and U.S. agriculture.

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## Statement of Thom Petersen

The Minnesota Farmers Union (MFU) appreciates the opportunity to comment on the state of the dairy industry in the Upper Midwest. MFU is a grassroots organization that has represented farmers in Minnesota since 1929. With that in mind, MFU would like to focus our comments on what our dairy farmers tell us our major issues.

(1) Milk Protein Concentrates: Many dairy farmers tell MFU that they are frustrated with lack of government action involving the continued increased importation of Milk Protein Concentrates (MPC's). MFU believes that many Minnesota dairy producers have a hard time understanding why MPC's can be imported at unchecked levels. In 2005, MPC imports were up 22 percent, and many feel that has a direct correlation on the price they receive for milk. Trade is a good thing but will not work in the long run if fairness issues are not addressed.

(2) Milk Income Loss Contract: The dairy farmers MFU represents are generally supportive of the Milk Income Loss Contract (MILC) program: while not perfect, the program does provide a safety net approach for our farmers when needed. MFU urges continued funding and a full extension of the program for the 2007 farm bill.

(3) Access to affordable health care: For many Minnesota farmers it is not surprising to see health care concerns rise to top of the issues they feel the government could do something about that could impact their dairy. MFU is concerned about rising premiums, near catastrophic high deductibles, and access to quality care in rural areas. Lack of access to affordable health care many times forces a member

of the family to work off the farm to obtain health care, and in expanding operations offering affordable health care to employees as a benefit is very challenging.

(4) Conservation: MFU's members strongly support the inclusion and continuation of conservation programs such as EQIP and CSP, and urge full funding and continued promotion to dairy farmers. MFU believes that it is critical in Minnesota (land of 10,000 lakes) that farmers receive recognition and compensation for past and future conservation investments.

(5) Fuel costs: Dairy farmers tell MFU that they are concerned about rising fuel costs and the affect it is having on their operations. They hope that Congress remembers farmers when working to address what many feel to be a crisis. Nothing explains the point more than a dairy farmer who told MFU in the past week, "The milk hauler, the feed delivery truck, and the fuel tanker all have added a fuel surcharge, and the vet has increased the farm call charge due to increased fuel costs. "Who do I pass that on to?" the farmer asked.

(6) Organic: MFU supports those dairy farmers who choose to transition to organic dairy production and urges Congress to continue to fund cost-share and research programs. MFU believes that programs need to exist that will help those farmers who choose organic to make the transition to a growing field.

MFU encourages the Committee to remember some important dairy farm numbers according to the Minnesota Department of Agriculture 2005 Minnesota Agricultural Statistics; 95 percent of all dairy farms in Minnesota milk 200 cows or less, 85 percent milk 100 or less, and over 40 percent milk 50 cows or less. These operations are very important to Minnesota's economy. MFU believes that access to good quality forage and water as well as processing facilities are among the many positive things that make Minnesota a great place to be a dairy farmer. Thank you.

**Prepared Statement of Lloyd Day, Administrator
Agricultural Marketing Service
U.S. Department of Agriculture**

**Before the
House Committee on Agriculture
Subcommittee on Department Operations, Oversight, Dairy, Nutrition & Forestry
May 31, 2006**

Mr. Chairman, good morning and thank you for the invitation to appear before the subcommittee today. Accompanying me is H. Paul Kyburz, Market Administrator for the Upper Midwest. My remarks will briefly highlight the general economic conditions facing U.S. agriculture, and then focus on the dairy industry here in the Upper Midwest.

The general economy continues to be strong with growth rates in 2006 expected to be similar to 2005, but below 2004. Increased energy costs, rising interest rates and high consumer debt loads are expected to result in slower, but still strong, domestic expenditures on food in 2006. U.S. exports, including agriculture products, are expected to grow with the decline in the value of the dollar. On May 9, 2006, the Department of Energy projected that 2006 diesel and natural gas prices will increase by 12 and 7 percent, respectively, over the 2005 increases of 33 and 19 percent, respectively. The costs of fertilizer, planting, harvesting, and drying will increase, and add about five cents per bushel to the cost of growing corn in 2006.

The dairy industry nationally has had two years of strong prices. Milk production continues to increase in response to near record milk prices in 2004 and 2005, restored availability of rBst, and improved forage conditions. Milk production is forecast to be up nearly 3 percent in 2006, following a 3.3 percent increase in 2005. The production growth is coming primarily from the Western States on larger herds; as the number of dairy operators continues to decline nationally. This growth in production continues to exceed dairy product demand. USDA's May forecast estimated the all-milk price to average between $12.35 and $12.85 per cwt in 2006, down over 15 percent from 2005.

Dairy production costs are expected to be higher in 2006 than in 2005, primarily due to increased energy and feed costs. Corn is expected to average about $2.40 per bushel, $0.40 higher per bushel over last year, while soybean meal prices are expected to be about $170 per ton as compared to $175 in 2005.

USDA forecasts 2007 milk production growth to be less than 1 percent, with farmers responding to higher feed costs and lower milk prices in 2006. The 2007 all-milk price is forecast to increase an average between $12.85 and $13.85, up 6 percent over 2006, as the result of lower production growth coupled with a higher growth rate in demand.

The Commodity Credit Corporation (CCC) is currently purchasing nonfat dry milk from western states. USDA estimates net removals to be about 110 million pounds in 2006 and 195 million pounds in 2007. CCC has reduced burdensome nonfat dry milk inventories (over a billion pounds in Fiscal Year (FY) 2003 to less than 20 million pounds currently).

The Milk Income Loss Contract (MILC) Program was extended for 2 years (through August 2007) by the Deficit Control Act of 2005. MILC Program makes direct payments to dairy producers when the Class I price in Boston falls below $16.94 per cwt. MILC Program was originally authorized in 2002 and generated over $2 billion in direct payments to producers for FY 2002 thru FY 2005 production. Payments resumed under the MILC Program in April and were retroactive to December 2005.

**International Markets Remain Firm**

U.S. milk producers benefited in 2005 from tight world supplies of dairy products and a relatively weak U.S. dollar. Reduced milk production in New Zealand, Australia and the European Union limited supplies available for export and coupled with robust demand, 2005 international nonfat dry milk prices averaged 10-15 percent above 2004 levels. With world prices above the price support rate, the U.S. significantly increased exports of commercial milk powders. On the import side, lower U.S. butter and cheese prices resulted in import reductions of butter and American-type cheese compared to 2004.

U.S. Imports of Selected Dairy Products (mil. pounds)

| | Butter and Butter Equiv. of Butter Substitutes | American Cheese | Cheese Other Than American | Milk Protein Concentrates | Casein |
|---|---|---|---|---|---|
| 2001 | 82.3 | 68.6 | 368.1 | 78.1 | 135.8 |
| 2002 | 36.1 | 84.0 | 388.2 | 91.4 | 126.8 |
| 2003 | 33.2 | 68.0 | 408.6 | 106.4 | 153.1 |
| 2004 | 55.0 | 66.6 | 393.8 | 96.6 | 147.2 |
| 2005 | 42.9 | 40.2 | 392.4 | 121.3 | 153.9 |

Source: U.S. Census

U.S. Exports of Selected Dairy Products (mil. Pounds)

| Exports | Butter and Butter Equiv. of Butter Substitutes | Cheese | Skim Milk Powder [1] |
|---|---|---|---|
| 2001 | 8.4 | 115.4 | 211.8 |
| 2002 | 8.5 | 118.8 | 164.0 |
| 2003 | 25.5 | 114.9 | 249.9 |
| 2004 | 19.8 | 135.3 | 510.6 |
| 2005 | 18.9 | 126.8 | 610.8 |

Source: U.S. Census

[1] Includes milk powders with less than 1.5 percent butterfat

Similar trade conditions are shaping up for 2006. Global demand for dairy products remains firm, the U.S. dollar continues to be weak, and U.S. skim milk powder prices are expected to be competitive. Some weakening in world prices is likely as global supplies increase. U.S. commercial exports of skim milk powders are expected to continue, at lower levels than in 2005 as world price falls below support rate and some sales to CCC resume.

**Milk Production Costs**

Feed costs make up a substantial portion of dairy operating costs. USDA's Economic Research Service (ERS) estimates milk production costs for several dairy production regions. Wisconsin and a portion of Minnesota are in the Northern Crescent region that extends east to include Michigan and the Northeastern states. Northern Crescent feed costs averaged about 67 percent of total operating costs in 2003-04, as compared to 72 percent for the U.S. According to the ERS cost and return survey, Northern Crescent feed costs averaged about 42 percent of the milk price – which is the gross value of production of milk sold/cwt – for the same period, while in the U.S. feed costs averaged about 50 percent of the milk price.

Feed availability in the Upper Midwest appears to be good in 2006. Good weather conditions last summer and a mild winter have resulted in a sharp buildup in hay stocks and favorable moisture conditions this spring exist throughout the area.

The increasing cost of energy has created opportunities for agriculture as well, contributing to higher feed costs. Ethanol production this marketing year is expected to account for 14 percent of U.S. corn production. For the 2006/07 marketing year, corn used in ethanol is forecast to rise 550 million bushels, or 34 percent, to 2.15 billion bushels. Assuming corn acreage as reported in the USDA spring planting intentions survey and trend yields, ethanol would account for 22 percent of the 2006 corn crop. While increasing corn prices result in higher costs for conventional feed, ethanol offers new feed alternatives that dairy and other livestock farmers can take advantage of in the form of distillers grains and solubles (DGS).

**Upper Midwest Dairy**

Wisconsin and Minnesota milk production in 2005 was 31.1 billion pounds, about 18 percent of the 177 billion pounds of U.S. milk production. The two states' 1.7 million cows represented 19 percent of the U.S. dairy herd of 9.0 million cows. In 1995, Wisconsin and Minnesota milk production was 32.4 billion pounds, about 21 percent of U.S. milk production of 155.3 billion pounds. Wisconsin and Minnesota total milk production has fallen by about 4 percent since 1995, while U.S. production has increased by 14 percent. Over one-quarter of the nation's dairy operations are located in Minnesota and Wisconsin.

**Milk Cows, Milk per Cow, Milk Production: Minnesota, Wisconsin, and U.S.**

| | Milk Cows 1,000 head | Milk per Cow Pounds | Milk Production Million Pounds | Licensed Dairy Operators |
|---|---|---|---|---|
| 1995 | | | | |
| Minnesota | 592 | 15,894 | 9,409 | |
| Wisconsin | 1,490 | 15,397 | 22,942 | |
| MN & WI | 2,082 | 15,538 | 32,351 | |
| % of U.S. | 22% | 95% | 21% | |
| **U.S.** | **9,466** | **16,405** | **155,292** | |
| | | | | |
| 2005 | | | | |
| Minnesota | 453 | 18,091 | 8,195 | 5,800 |
| Wisconsin | 1,236 | 18,500 | 22,866 | 15,300 |
| MN & WI | 1,689 | 18,390 | 31,061 | 21,100 |
| % of U.S. | 19% | 94% | 18% | 27% |
| **U.S.** | **9,041** | **19,576** | **176,989** | **78,295** |

Source: USDA, NASS

The Upper Midwest Federal Milk Marketing Order regulates the processors and manufacturers who purchase a major share of Minnesota and Wisconsin milk, along with some milk from North and South Dakota, Iowa, and Illinois. In 2005, 22.4 billion pounds of milk was pooled on the Upper Midwest order (Federal Order 30), about 20 percent of the milk marketed through all 10 Federal orders. Two-thirds of the Upper Midwest milk was used in cheese, while about 20 percent was used for fluid milk products.

Cheese will continue to be the major use of milk in the Upper Midwest. However, growth in Western milk production and commodity cheese making capacity is shifting incentives for the Upper Midwest industry towards artisan cheeses and other value-added forms of dairy product production. The Wisconsin Specialty Cheese Institute and the Wisconsin Dairy Business Innovation Center are helping the shift in that direction.

**Milk Price, Income Support, and the Farm Bill**

With the 2007 farm bill on the horizon and the World Trade Organization (WTO) trade negotiations continuing, it can be expected that milk price and income support, along with the other farm programs, will receive attention in the months ahead.

The Milk Price Support Program (MPSP) supports milk prices at safety net levels by purchasing and storing dairy products (cheese, butter, and nonfat dry milk). Congress mandates a $9.90 per hundredweight (cwt) milk support level and the CCC calculates dairy product purchase prices that allow manufacturers to pay farmers that price for their milk on average. The Secretary may make changes twice per year to reduce costs in the relative nonfat dry milk, butter and cheese prices.

The Farm Service Agency has implemented the extended MILC Program to support dairy farm income. For the October 1, 2005, through August 31, 2007 period, a dairy farm operation's monthly payment will equal the eligible milk quantity sold in that month multiplied by 34 percent of the difference between $16.94 per cwt and that month's Boston Class I milk price. The 2002 Farm Bill originally set the payment rate factor at 45 percent.

As to the eligible quantity, the MILC Program caps milk eligible for payments at 2.4 million pounds per dairy farm operation. The purpose of the program is to mitigate the decline in small to mid-size dairy operations. Regions with more dairy operations receive a larger share of MILC Program payments than regions with fewer operations. Large dairy operations can attempt to receive a larger MILC payment by choosing a payment month that they believe will have a higher payment rate. Wisconsin dairy farmers received 21 percent of the MILC payments while being home to 23 percent of all dairy operations. Similarly, Minnesota producers received nearly 8 percent of the MILC payments, as 9 percent of dairy locations are located there. Conversely, California, which has 3 percent of dairy operations, received 7 percent of all MILC payments.

Shares of Milk Production and MILC Payments

| | Share of Dairy Operations | Share of MILC Payments |
|---|---|---|
| | *Percentages* | |
| California | 3 | 7 |
| Idaho | 1 | 2 |
| New Mexico | 4 | 1 |
| Minnesota | 9 | 8 |
| New York | 10 | 9 |
| Pennsylvania | 13 | 9 |
| Wisconsin | 23 | 21 |

Based on expenditures under the original MILC program. The MILC Program is not expected to have a significant impact (<.2 percent) on total U.S. milk production.

The Dairy Export Incentive Program (DEIP) is an export subsidy program that allows exporters to bid for bonuses to enable export sales of butter, cheese, and nonfat dry milk. The program is currently inactive with the last subsidies paid in FY 2004. World market conditions are such that the U.S. price is the world price, and no bonus is needed to sell dry milk powders.

With these programs in mind, preparations for a new farm bill are now beginning. USDA held 52 forums throughout the country. Thousands of comments were received from the forums. The USDA has analyzed these comments and prepared 41 summary papers that are available on the USDA website. In addition, the Secretary recently released the first in a series of analytical papers on risk management intended to provide factual information and facilitate discussion about the best policy approaches for the new farm bill. While there appears to be uncertainty surrounding when the actual farm bill debate will occur, USDA is preparing to be actively involved in the process.

**Agricultural Marketing Service Activities**

Finally, I would like to speak briefly about two of the programs of the Agricultural Marketing Service. The Federal milk marketing order program is one that continually changes to reflect relevant marketing conditions facing the dairy industry. Several regulatory decisions are in various stages of completion that relate to the Upper Midwest. The Fluid Milk Product Definition Recommended Decision affecting all 10 orders was issued this month proposing that Class I fluid milk products must contain greater than 6.5 percent nonfat milk solids and greater than 2.25 percent true protein. Drinkable yogurt, containing greater than 20 percent yogurt, is proposed to be in Class II. Public comments on this decision may be submitted through July 17.

The issue of Class III/IV Manufacturing Allowance levels used to calculate the value of milk was heard at a national hearing in January of this year. Post-hearing briefs were due February 17, 2006. Possible adjustments in the make (manufacturing) allowances in Class III and IV products are under consideration. The Department is analyzing the record.

Several hearings have been held for the Upper Midwest, Mideast, and Central orders that address pooling and re-pooling issues. Interim rules and recommended decisions have been issued. Recommended decision comments were due April $24^{th}$ for all three orders and final decisions are being prepared.

The Federal order rulemaking process has received significant attention recently by all sectors of the industry regarding the length of time involved to complete regulatory actions. AMS undertook an extensive internal review of the process and has developed several new rulemaking initiatives and customer service standards. Our goal is to improve timeliness and transparency while at the same time maintaining the opportunity for public involvement that currently exists. Through this initiative, AMS expects to improve non-emergency rulemaking timeliness by reducing the time required to complete regulatory actions by over one-third.

AMS also oversees the operations of the National Dairy Promotion and Research Program and the National Fluid Milk Processor Promotion Program. As fluid per capita consumption of fluid milk products continues to decline, these programs are proving to be a very positive force in the development of markets for milk and dairy products. In 2005, producers contributed more than $260 million and processors contributed about $105 million to be spent on a variety of activities to expand the markets for fluid milk and dairy products. Among the most important is the effort to provide the products consumers demand. One such effort, the promotion of single-serve milk in plastic bottles for schools and in restaurants is expected to add over a billion pounds of milk to fluid sales. Dairy Management Inc. (DMI) has become partners with several restaurant chains to increase their sales of fluid milk. Thus far, during the initial launch in 20,000 restaurants, combined weekly average milk sales have grown exponentially. More restaurants will have national rollout of the single-serve containers in June. In addition to milk, the National Dairy Promotion Program is partnering with a fast food chain to test and market a 7-ounce strawberry yogurt cup that is now a permanent menu option. This introduction helped lead to a 7 million pound annual increase in milk used through foodservice.

**Conclusion**

In conclusion, although the U.S. dairy industry is experiencing a year of reduced prices after two years of all-milk prices averaging $15.45 per cwt., prices are forecast to increase in 2007. Milk prices in the Upper Midwest are moving with U.S. prices. The MILC program has been extended, and will provide payments to farmers up to the 2.4 million pound milk production cap. The demand for milk continues to be strong domestically and for exports of skim milk powders. The Upper Midwest dairy industry continues to be a major supplier of milk and dairy products to U.S. consumers and a major positive factor in the region's economy, drawing on institutions such as the Wisconsin Specialty Cheese Institute and the Wisconsin Dairy Business Innovation Center, and its innovative cooperatives and cheesemakers.

This concludes my statement, Mr. Chairman. I would be pleased to respond to questions.

Mr. Chairman and members of the committee, thank you for inviting me to address the State of the Upper Midwest Dairy Industry. My name is Robert Cropp. I am professor emeritus, Department of Agricultural and Applied Economics, University of Wisconsin, Madison, Wisconsin. For the past 40 years I have taught university classes, conducted research and carried out extension education in dairy marketing and policy and agricultural cooperatives.

Not unlike much of the U.S. dairy industry, the Upper Midwest has and continues to experience rather rapid structural changes at both farm and milk plant levels. Table 1 shows changes in the dairy farm structure over the 10-year period of 1996 – 2005. In 2005, the three states of Iowa, Minnesota and Wisconsin still had 10 to 20 percent of their dairy herds with fewer than 30 milk cows, and a 22 to 37 percent between 30 and 49 cows. About a third of the herds had 50 to 99 cows. Just 10 to 16 percent had 100 to199 cows and 1 to 5 percent with 200 plus cows. During this 10 year period all size groups, except for the 200 plus cows, experienced rather large percentage declines in farm numbers, with decline greater for the smaller herds. The 200 plus cow herds had substantial increases in numbers (77 percent in Minnesota to 157 percent in Wisconsin). The total number of dairy herds during this period declined more than 45 percent, a little more than a 40 percent decline in the total number of U.S. dairy herds. But, yet with this decline in the number of dairy herds, the average size herd is still only about 80 cows in the Upper Midwest compared to an average of 115 cows nationally.

Table 1: Structure of Upper Midwest Dairy Herds, 1996 as compared to 2005

| Herd size (number of cows) | Iowa | | | Minnesota | | | Wisconsin | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1996 | 2005 | % Ch. | 1996 | 2005 | % Ch. | 1996 | 2005 | %Ch. |
| | ----percentages--- | | | ---percentages--- | | | ---percentages--- | | |
| 1 to 29 | 27.1 | 21.2 | -59.2 | 20.0 | 10.7 | -70.5 | 18.5 | 14.3 | -56.0 |
| 30 to 49 | 27.1 | 22.0 | -57.7 | 37.3 | 32.8 | -53.7 | 35.2 | 25.5 | -58.9 |
| 50 to 99 | 34.4 | 35.6 | -46.1 | 34.5 | 41.4 | -36.8 | 35.6 | 41.8 | -33.3 |
| 100 to 199 | 10.0 | 16.0 | -20.0 | 7.5 | 10.0 | -30.1 | 9.4 | 12.1 | -26.9 |
| 200 plus | 1.5 | 5.2 | +85.7 | 1.5 | 5.2 | +76.5 | 1.4 | 6.2 | +156.8 |
| Number of herds | 4,800 | 2,500 | -47.9 | 11,000 | 5,800 | -47.3 | 27,000 | 15,300 | -43.3 |
| Average herd size (cows) | 52 | 78 | +50.0 | 54 | 78 | +44.4 | 54 | 81 | +50.0 |

Source: USDA, NASS

Table 2 breaks down the herd size for 2005 into more categories and shows the percentage of milk produced by each category. As shown, Iowa has 1.2 percent of its herds with 500 plus cows, but size group accounts for 21.0 percent of the state's milk production. For Minnesota this size group represented 1.0 percent of the herds but 14.5 percent of the milk, and for Wisconsin this was 1.3 percent of the herds and 16.0 percent of the production. This compares to the U.S. where 3.9 percent of the herds are 500 plus cows that account for 49.5 percent of the milk. Herds with 200 plus cows in the Upper Midwest account for about 5 percent of the herds, but about a third of the milk. This compared to about 10 percent of the herds having 200 plus cows in the U.S. producing about 65 percent of the milk.

Table 2: Structure of Upper Midwest Dairy Herds and Percent of Milk Production, 2005

| Herd size(number of cows) | Iowa | | Minnesota | | Wisconsin | |
|---|---|---|---|---|---|---|
| | % Herds | % Milk | % Herds | % Milk | % Herds | % Milk |
| 1 to 29 | 21.2 | 2.0 | 10.7 | 2.5 | 14.3 | 2.0 |
| 30 to 49 | 22.0 | 8.0 | 32.8 | 15.0 | 25.5 | 11.0 |
| 50 to 99 | 35.6 | 27.0 | 41.4 | 34.0 | 41.8 | 34.0 |
| 100 to 199 | 16.0 | 26.0 | 10.0 | 17.0 | 12.1 | 19.0 |
| 200 to 499 | 4.0 | 16.0 | 4.1 | 17.0 | 4.9 | 18.0 |
| 500 plus | 1.2 | 21.0 | 1.0 | 14.5 | 1.3 | 16.0 |

Source: USDA, NASS

Table 3 shows what has happened to milk cow numbers in the Upper Midwest as compared to the U.S. The decline in cow numbers is much less than the decline in dairy farm numbers reflecting expansions in the size of the dairy herd. During the 10-year period of 1996-2005, both Iowa and Minnesota experienced a decline in cow numbers of more than 22 percent, compared to a decline of about 15 percent in Wisconsin and only 3.5 percent for the U.S. as a whole.

Table 3: Milk Cow Numbers in the Upper Midwest and the U.S., 1996 and 2005

| State | --1,000 head in 1996-- | --1,000 head in 2005-- | ---Percent Change--- |
|---|---|---|---|
| Iowa | 250 | 194 | -22.4 |
| Minnesota | 598 | 453 | -24.2 |
| Wisconsin | 1,449 | 1,236 | -14.7 |
| U.S. | 9,372 | 9,041 | - 3.5 |

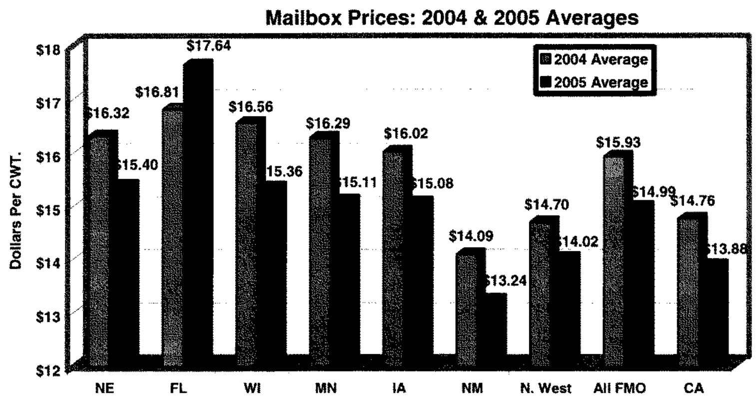
Source: USDA, NASS

Table 4 shows total milk production in the Upper Midwest and the U.S. for 1996 and 2005. During this ten year time period both Iowa and Wisconsin had a small increase in total milk production, 5.1 percent and 2.3 percent respectively. However, Minnesota experienced a 13.2 percent decline in milk production. The nation's milk production increased 14.9 percent during this period. The decline in milk production for Iowa and Wisconsin appears to have ceased somewhat with new dairy farm investments starting to produce a slow increase in milk production.

In fact, Wisconsin started to experience an increase in milk cow numbers during 2005 and ended the year with an increase in milk production of 3.5 percent. Iowa had a 4.4 percent increase in milk production from a few more cows and a strong increase in milk per cow. In Minnesota 3.4 percent more milk per cow more than offset 2.2 percent fewer cows, netting a 1.1 percent increase in milk production. Dairy development initiatives in Iowa appear to be having a positive impact. Wisconsin legislature has been positive for dairy development including funds for dairy expansion planning, investment tax credit, low interest loans for adding cows, funds to support grazing, and a recent siting legislation that will greatly improve the process for dairy farmers wanting to expand their dairy operation. The state of Minnesota is attempting to pass and implement similar legislation to develop their dairy industry.

The lack of a growing milk supply in the Upper Midwest has led to strong competition between dairy cooperatives and other milk processors for milk to fill their processing plants and to meet their customer needs for cheese and other dairy products. Upper Midwest dairy cooperatives and other milk processors pay dairy farmers substantial premiums above regulated federal milk marketing order minimums. Similar premiums are not paid by milk processors to dairy farmers in the growing milk production region of the West. Further, California is not part of the federal milk marketing order systems and its state milk pricing system sets minimum dairy producer prices for milk going into butter, milk powder and cheese below that of federal milk marketing order minimum prices. The result is mailbox milk prices paid by dairy cooperatives and other milk processors to Upper Midwest dairy producers more than a $1.00 per hundredweight higher than what is paid in California and other western states. While these higher mailbox prices are beneficial to Upper Midwest dairy producers, these higher premiums are not sustainable long run. This difference in milk cost to Upper Midwest cheese plants makes it difficult for them to compete price-wise against California and other Western cheese plants in marketing cheese to a competitive national market. Upper Midwest dairy cooperatives and other milk processors need to generate sufficient net plant margins for capital investment in plant and equipment, if they wish to maintain modern and more efficient processing technology required to be competitive with the new and larger processing plants recently built and being built in the West.

The chart below shows average mailbox prices for selected states for years 2004 and 2005.




Source: USDA, AMS

Competitiveness of the national cheese market and tight plant margins has forced consolidations of cheese and other manufacturing milk plants in the Upper Midwest. Any major new cheese plant has not been constructed in more than 18 years. Table 4 shows the change in the number of Upper Midwest cheese plants during the ten period of 1996 – 2005. The number of cheese plants declined by 18% in Wisconsin, 31% in Minnesota with no change in Iowa. This compares to only 0.5% decline in the number of U.S. cheese plants.

Table 4: Change in the number of Upper Midwest Cheese Plants, 1996 – 2005

| State | Number of Cheese Plants in 1996 | Number of Cheese Plants in 2005 | Percent Change |
|---|---|---|---|
| Iowa | 7 | 7 | No change |
| Minnesota | 16 | 11 | - 31.3% |
| Wisconsin | 140 | 115 | - 17.9% |
| U.S. | 412 | 410 | - 0.5% |

Source: USDA, NASS

With the Upper Midwest dairy industry characterized by a more than 40 percent of their dairy herds having fewer than 50 cows, it will continue to experience a rather rapid decline in dairy farm numbers. Most of these smaller herds have outdated facilities in need of repair and updating and are operated by older farmers who will be retiring. In most instances, these small dairies are not large enough to support an adequate family living. Yet, the Upper Midwest will continue to have a relatively large number of small dairy farms that can be profitable and sustainable. These are dairy farms that have adopted low inputs through grazing and/or are producing milk for the growing niche markets such as organic or BsT free milk and dairy products that command a higher price than traditional produced milk and products. Others are supplying milk to smaller cheese plants that are making higher margin specialty cheeses. Specialty cheeses now account for 15 percent of the cheese made in Wisconsin. And still others have successfully entered into on-farm production and sales of beverage milk, cheese and yoghurt. These examples are fine for those who wish to remain small and have the associated lifestyle. But, they will continue to account for a relatively small share of Upper Midwest's total milk production.

But, if the Upper Midwest is to slow or stop the decline in the number of milk cows and total milk production, there needs to be more larger 500 cow, 1,000 cow and even larger cow dairy operations. The Wisconsin's recently implemented siting rules will help make that possible. But also, a number of dairy farms in the 50 to 99 cow group need to modernize and grow their dairy operation to a size that will support two or more families. This is because 40 percent of the Upper Midwest herds are in the 50 to 99 cow size and account for about a third of the total milk production. Without this herd expansion it may not be possible to offset the exiting of smaller herds and to grow, let alone maintain its dairy industry entirely from additional 1,000 plus cow herds.

There are a number of these 50 to 99 cow farms that have already expanded and modernized and now serve as models for others to follow. Many have used the old dairy facility to put in a low cost labor saving milking parlor and built a free stall barn for better cow comfort and reduced labor time to feed and care for the cows. Many of these have expanded their dairy herd to 125, 250 or more cows. Cost data show that these farms can be very competitive with the larger cow operations from a per hundredweight cost of milk production comparison. And maybe even more important, they provide a favorable lifestyle that allows the families to have some free time, take a vacation, to engage in more family activities and the like. Planning grants, investment tax credit, and low interest rate loans to add cows previously mentioned are examples of programs in Wisconsin that are assisting these dairy farmers to expand and modernize.

The Upper Midwest has the land resources, climate, existing infrastructure and market access for a competitive and profitable dairying. But, it needs to recognize that the dairy industry is a national market for milk and dairy products and is becoming more international. The Upper Midwest dairy farmers, cheese plants and other milk processors need to compete with the best in this national market and yet be profitable. This requires the dairy herd modernization and expansion as mentioned. State programs as described can help foster this needed adjustment. But since milk and dairy product prices are determined by national and international market factors, there is a need for effective federal dairy policy. Dairy farmers often take on substantial debt when they modernize and expand. If upon completion of a modernization project, the dairy experiences a long period of depressed milk prices, they can experience considerable financial stress and even financial failure. Federal dairy policy is needed to provide dairy farmers with a safety net from these low milk prices.

The existing Milk Income Loss Contract Program (MILC) has provided an effective safety net to Upper Midwest dairy farmers. The program is not perfect. The $16.94 Class I Boston price is well above market clearing levels the majority of the time. Thus, the program is price enhancement rather than price risk protection, at least for those dairy farms that receive MILC payments on their entire milk production. Some argue that the 2.4 million pound annual payment discriminates against larger dairy farms and regions of the U.S. with mainly large herds. Yet, some type of counter-cyclical program can be effective in providing dairy farmers with an appropriate safety net and at a reasonable federal budget exposure level. Some preliminary analysis we have done shows that a target price on manufacturing use milk in the $10 to $11 per hundredweight range would not be burdensome to the federal budget and would provide a more effective safety net to dairy farmers than the existing $9.80 (3.5% butterfat test) federal dairy support price by itself. For one thing, the $9.80 support price by itself is too low of a safety net to be of much help to dairy farmers and it definitely is not a floor price. During the depressed milk prices of 2000, the Class III price (milk used for cheese) was below support 7 of the 12 months and fell to a low of $8.57 in November. Then in 2002 the Class III price was below support for 3 of the 12 months and in 2003, for 6 of the 12 months. Currently, the support program works fairly well for the CCC in purchasing nonfat dry milk during surplus milk periods, but it does not work very well for supporting cheese prices and in turn Class III prices for several reasons. There are proposals by USDA, the National Milk Producers Federation and others to make changes in the CCC price support program to make it a better floor price. But, due to how the dairy industry now operates in the manufacture and marketing of cheese, I question if the proposed changes will correct the deficiencies of the CCC purchase price support program. Plus the $9.80 price support program does not score well under existing WTO rules[1]. I would encourage Congress in the 2007 Farm Bill debate to give serious consideration to a counter-cyclical support program for dairy.

Thank you for your kind attention. I would be happy to answer any questions.

[1] WTO rules establish allowable Aggregate Measure of Support (AMS), that is Amber Box trade distorting programs. U.S. is allowed a maximum of $19.1 billion of Amber Box programs. The dairy price support program is considered to contribute about $4.5 billion, 25% to the Amber Box. This is determined by taking the difference between the $9.90 support price (at 3.67% butterfat test) and a world reference price of $7.25 (a difference of $2.65) times U.S. milk production.

**State of Wisconsin**
Jim Doyle, Governor

**Department of Agriculture, Trade and Consumer Protection**
Rod Nilsestuen, Secretary

June 29, 2006

House Committee on Agriculture
Subcommittee on Department Operations, Oversight, Dairy, Nutrition, and Forestry
1301 Longworth House Office Building
Washington, DC 20515

Dear Honorable Subcommittee Members:

As Secretary of the Wisconsin Department of Agriculture, Trade and Consumer Protection (DATCP), I would like to enter these comments into the record of the May 31, 2006 hearing, held by the House Subcommittee on Department Operations, Oversight, Dairy, Nutrition, and Forestry, reviewing the state of the Upper Midwest dairy industry.

Wisconsin is "America's Dairyland." Dairy is the centerpiece of the Wisconsin's $51.5 billion agriculture sector, accounting for $20 billion of that total. It touches every county and every citizen:

- Every cow adds $13,737 to the economy and $550 to the tax base.
- Overall the dairy industry generates $2.1 million per hour for our state.
- The state's cheese, butter and ice cream plants pump more than **$39,000 per minute** into the state's total economy.
- In 2005 the state produced 3.5 percent more milk, added 17 new dairy plants and expanded 13 existing plants, and produced 7 percent more high-end specialty cheese.

That's why continuing the Milk Income Loss Contract (MILC) program is the next Farm Bill is crucial for Wisconsin. Through the strong leadership of Sen. Herb Kohl and Rep. Dave Obey, MILC program payments under the 2002 Farm Bill were a necessary safety net for Wisconsin dairy producers and rural communities suffering through the milk price collapse of 2002 and the first half of 2003.

Once milk prices recovered, the MILC program was not triggered through most of 2004 and 2005. The program has worked just as it was supposed to... as a cushion to keep producers afloat in a sea of low milk prices. This counter-cyclical program would put dairy on equal footing to other commodities if Congress funded it all the way through the life of the current Farm Bill, as Rep. Obey has proposed.

MILC is not perfect. But this landmark dairy safety net marked a significant break from the regional bias in federal dairy policy that guarantees the highest prices to producers who are farthest away from Eau Claire. For once, our producers have not been penalized for living in Wisconsin.

The MILC program has been highly successful in reducing the rate of dairy farm loss in Wisconsin. The table below shows how MILC kept fewer families from leaving the family farm, in spite of historically low milk prices experienced in 2002 and the first half of 2003.

**(MORE)**

| Change in Wisconsin Dairy Farms | | | | |
|---|---|---|---|---|
| Year | Jan. 1st Dairy Farm Numbers | Change from Previous Year | Percentage Change | All Milk Price ($ cwt) |
| 1998 | 23,158 | -1,795 | -7.2 | $15.50 |
| 1999 | 21,899 | -1,259 | -5.4 | $13.80 |
| 2000 | 20,217 | -1,184 | -5.4 | $11.70 |
| 2001 | 19,096 | -1,619 | -7.8 | $14.80 |
| 2002 | 17,782 | -1314 | -6.8 | $12.11 |
| **2003** | **16,968** | **-814** | **-4.6** | **$12.65*** |

**(Data in bold indicates year since inception of the MILC program)**
*preliminary all-milk price data for 2003; 2003 prices were significantly depressed until July
*Source: Wisconsin Agricultural Statistics Service*

While MILC proved to be a safety net for states like Wisconsin with small-to-medium sized dairy herds, the program had no negative impact on states with larger herds. States like California, Idaho and New Mexico, for example, all increased production significantly during the 2002-3 timeframe, when MILC payments were being made.

We still have a ways to go to reform federal dairy policy and create a level playing field that provides Upper Midwest dairy farmers with strong market prices and reasonable returns on their investment and labor. But the MILC program marked significant progress toward fairness and equity. Along with the milk price support program, this program creates a more credible safety net for producers when market prices fall.

The MILC program was put into the 2002 Farm Bill to try a new approach for dairy. The evidence shows that this innovative dairy policy has been very successful and should be continued in the next Farm Bill.

**Grow Wisconsin Dairy Initiative**
Of course, dairy producers prefer to get their income from the marketplace. Wisconsin Governor Jim Doyle's Grow Wisconsin economic development plan has made great strides in keeping our $20.6 billion dairy industry growing and vibrant.

The Governor expanded the state dairy investment tax credit to all livestock producers who modernize. We provided close to $1 million in grants to about 100 dairy businesses to help *them* modernize. Over the past four years, 30 companies have modernized and reinvested $200 million in their operations.

At the same time, nearly 900 dairy producers have pumped more than $282 million into their operations since 1996 with the help of grant programs from the state Department of Commerce.

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These producers have added 1.2 billion pounds of milk to Wisconsin's supply chain.

The grants are part of the Governor's Grow Wisconsin Dairy Initiative, which aims to strengthen the state's economy and its rural communities by increasing milk production, modernizing farms, creating new dairy enterprises and increasing specialty cheese and dairy volume.

The next Farm Bill should provide funding for these types of state initiatives that promote dairy profitability by expanding the market for dairy products.

Reauthorizing dairy compacts would be a giant step backwards and ignite all the old battles. Compacts are neither innovative nor market-expanding; they're nothing more than old fashioned protectionism.

**Support State-Federal Partnerships**
States like Wisconsin have historically been in the forefront of policy innovations that become adopted nationally. We should use this same model to guide us as we move federal dairy policy forward in the next Farm Bill.

That's why I strongly encourage Congress to increase Farm Bill funding for other state-federal partnerships that expand markets and test ideas for enhancing farm profitability. Such projects are uniquely tailored to meet local needs and opportunities. Examples include:

***Bio-energy/Products***
Although dairy pumps more than $39,000 per minute into the state's economy, Wisconsin's 1.2 million dairy cows each generate about 14 gallons of waste per day. Federal policies can help dairy to stay competitive by helping farmers develop new systems and methods that increase profits, reduce waste and create new revenue streams.

Wisconsin has 21 anaerobic digesters in or near operation, the most of any state. These digesters can generate more than 58 million kilowatt-hours of electricity every year, with a value of $3.5 million.

Nor is electricity the only potential money-maker for dairy farmers. Other bi-products from technology-altered manure include compost, bedding, a propane gas alternative and even clean water.

Governor Doyle's recently announced Promoting Our Wisconsin Energy Resources (POWER) initiative includes a grant program to help Wisconsin farmers take advantage of technology to turn waste material into renewable energy. It is part of a broad effort to make Wisconsin the nation's leader in energy independence. Our goal is to promote economic growth and energy security in both rural and urban areas of Wisconsin by using both bio based products and bio energy in environmentally sound ways.

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The Farm Bill should foster these types of efforts by continuing Section 9006 renewable energy grants and expanding them to include bio based industry grants and forestry. Specifically, the Farm Bill should offer financing (such as loan guarantees) for digesters and other technologies, as well as help in building the business models and arrangements that make the economics work better.

*Conservation*

Not only do bio fuels and related bio based products offer tremendous opportunities to meet our nation's growing energy needs and strengthen the agricultural economy; developing more beneficial uses for farm wastes will reduce environmental compliance costs for producers while at the same time protecting our land, air and water.

Increased funding of state-federal conservation partnerships isn't just a good idea; it may be necessary for future farm policy. The next Farm Bill could shift some farm payments away from trade-distorting crop subsidies in order to comply with our obligations under the World Trade Organization (WTO).

I encourage Congress to give states more flexibility to use environmental stewardship funds in a manner that builds on state farm conservation efforts. A state block grant – piloted in cutting-edge states like Wisconsin - could help producers develop new, innovative ways to practice environmental stewardship:

- The Wisconsin Agricultural Stewardship Initiative (WASI) is helping researchers find science-based answers that promote farm profitability while protecting the environment and food supply.
- For the first time ever, Wisconsin will invest more than $1 million in cost sharing over the next two years for farmers to do nutrient management planning.
- DATCP is leading a Conservation Innovation Grant (CIG) project that will evaluate best management practices to control odor levels and air emissions on dairy and livestock operations. This is exactly the kind of project the federal government should promote. However, the grant process was very competitive, with about 175 project proposals submitted from entities in 48 states. Besides Wisconsin, NRCS selected 53 other projects to receive more than $19 million in funding. With increased funding, states could do more of this kind of research and experimentation to test new policy ideas locally that may one day be ready for broad national or regional implementation.

*Animal Identification*

The health of our dairy and meat industries - and more importantly our customers - also depends on the health of our animals. The next Farm Bill should include a title authorizing a mandatory animal identification system with funding to help states implement a national system as soon as possible. USDA's estimated additional cost of about $600 million over five years for a national system is a critical investment.

*Johne's Disease Funding*

This contagious bacterial disorder dramatically reduces milk production in infected herds. Studies show that, if a producer has 100 cows and just 10 percent of them are infected, he's probably losing

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almost $24,000 a year. Wisconsin has made great strides in managing this disease with the help of federal funding for our Johne's Disease Risk Management Program. Under this initiative, Wisconsin dairy and beef producers may receive up to $1,000 in grants for equipment and materials to help control Johne's disease on their farms and work with veterinarians trained and certified to conduct Johne's disease risk assessments and develop herd plans. To be eligible, farmers must have had an initial or renewal risk assessment done in the past 14 months or complete one before applying for these funds. These grants must be used in projects recommended in their herd plans to help control Johne's disease long-term. To continue our progress, the next Farm Bill should authorize a stable funding source for Johne's Disease management programs.

*Risk-Based Dairy Inspection Program*
States also have good ideas for streamlining food safety policies that would enhance public health, as well as the economic vitality of animal agriculture.

A more risk-based approach to Grade A dairy farm inspection would reduce or eliminate routine inspections on operations that have a history of significant compliance with current standards that have a direct bearing on food safety and public health. This system would reserve on-site inspection for dairy farms with a history of non-compliance with critical milk-safety-related violations. Piloting this system at the state level could show us how to reallocate inspections toward other higher risk food safety and food security activities.

**Conclusion**
What we're doing here in Wisconsin is a great example of what can be done across rural America to support our American dairy industry, protect the environment, boost rural communities, and preserve family dairy farms.

These Wisconsin initiatives show why the next Farm Bill should place a greater emphasis on supporting state projects that have national significance. Some new programs may be ready for broad national implementation; others should be implemented by individual state partnerships and pilot programs to allow for innovations to be trialed and solutions to be tailored to meet local needs and opportunities.

The importance of farming and rural Wisconsin goes beyond economics. These priorities will help us pass the baton to the next generation of dairy farm families, who will preserve a way of life that is the backbone of Wisconsin's culture and values. Please keep these thoughts in mind as you work to develop dairy policies for the next Farm Bill.

Sincerely,

Rod Nilsestuen

Rod Nilsestuen
Secretary

## STATEMENT OF CLINT FALL

Chairman Gutknecht, Congressman Peterson, Members of the Subcommittee:

My name is Clint Fall, president and CEO of First District Association. I want to thank you for the opportunity to testify today regarding the status of the upper Midwest dairy industry, and to give you the perspective of our members on that important topic.

The dairy sector is extremely important to the economy of the Upper Midwest, particularly Minnesota and Wisconsin. Minnesota's dairy sector annually pumps more than $1.2 billion into our state economy, and the total economic impact of Minnesota's dairy production is estimated to be $3.1 billion. The total employment impact of Minnesota's dairy industry is estimated to be 27,402 jobs, including direct employment of 6,111 jobs and indirect or induced employment of 21,291 jobs. When the multiplier effects are fully considered, it is estimated that each Minnesota dairy cow generates $5,000 in economic activity for the State.

According to the Wisconsin Milk Marketing Board, Wisconsin's dairy industry has a $20.6 billion impact on the state's economy and employs 160,000 people, accounting for nearly 40 percent of all Wisconsin agriculture jobs. The economic impact of dairy farming in Wisconsin is more than twice as large as the citrus industry's economic impact in the state of Florida and eight times as large as the potato industry's economic impact in the state of Idaho. The average Wisconsin dairy cow generates more than $17,000 a year in economic activity, which circulates throughout local communities.

First District Association is a dairy farmer-owned cooperative based in Litchfield, Minnesota. The farmer-members for First District are located in Minnesota, Wisconsin, and Iowa and produce over 1.7 billion pounds of milk per year. Over 120 million pounds of Cheddar cheese, 22 million pounds of whey protein concentrate and 32 million pounds of lactose are produced annually. Our single cheese processing plant in Litchfield is a state-of-the art operation, and one of the few processing plants with the technical capability to extract dairy calcium. Our customers include the largest chocolate manufacturers, infant formula manufacturers, bakery companies, dairy food processors (yogurt, cream cheese, processed cheese) and pharmaceutical companies.

I am particularly pleased to be part of this panel of my colleagues representing dairy processing companies, because it is an excellent opportunity to point out how critical farmer-owned cooperatives are in the dairy processing sector, not only in the Upper Midwest, but also in the Nation as a whole. In Minnesota and Wisconsin, about 85 percent of milk is marketed through cooperatives. It is estimated that 60–65 percent of cheese, and nearly 100 percent of butter and milk powder in Minnesota and Wisconsin are processed by cooperatives.

As a dairy farmer member-owned processing and manufacturing cooperative, our goal is to maintain a competitive operation, not only to provide our farmers a fair price for their milk, but also to return a profit to them from the dairy products that we produce and market.

As a member of the Midwest Dairy Coalition and the National Milk Producers Federation, we are also active in supporting Federal dairy policies that are beneficial to dairy farmers of the Upper Midwest and the Nation as a whole.

Dairy is highly regulated. The structure of Federal dairy policy has always played a significant role in the status of the Upper Midwest dairy industry, although not always for the better. There has been a tendency in Federal dairy policy to promote high minimum prices for class I (fluid) milk and to instill policies that put downward pressure on the prices for manufactured dairy products. Whether it is the ongoing structure of the Federal milk marketing order system, or past experiments with regional dairy Compacts, Federal dairy policy has often placed the Upper Midwest at a competitive disadvantage. For the Upper Midwest, where about 85 percent of our milk is manufactured into cheese, butter, and powder, anything that artificially inflates the price of class I at the expense of manufactured classes of milk is detrimental to our region.

Therefore, one of our clear policy goals has been to promote policies that treat producers in the Upper Midwest more equitably, and to work to reform or eliminate those policies that discriminate against our region.

As we move into the debate over the structure of the next farm bill, I would like to make several points about policies that are important to our producers and the Upper Midwest dairy industry as a whole.

### Milk Price Support Program

The milk price support program has been the core base of support for milk and dairy product prices for decades. Without a doubt, it is an important program that should be continued. But equally clear is that the milk price support program is in great need of reform. The current price support level of $9.90 per hundredweight is a very low level of support. But even at that low level, the current price support program has proven to be a porous and ineffective floor. Between January 2000 and February 2003, the class III price fell below support in 12 of 37 months, falling as low as $8.57 in November of 2000.

The central premise of the milk price support program is that dairy product manufacturers will sell dairy products to the Commodity Credit Corporation whenever market prices fall below the product purchase prices established by USDA. Yet what we are seeing is that manufacturers are reluctant to sell product, particularly cheese, to the CCC. One of the key reasons for this is that the costs of selling product to the CCC are higher than the costs of selling to the commercial market. These higher costs are associated with CCC processing and packaging standards and inspection and grading requirements that are different from industry standards. In addition, storage and finance costs are higher because it takes longer for the CCC to take delivery of product and make payment.

To address these unique costs associated with selling surplus product to the CCC, we support a proposal by NMPF to increase the purchase prices for cheese, nonfat dry milk and butter, to reflect those unique costs. I believe these changes could be made administratively by USDA in order to better enforce the current statutory price support of $9.90 per hundredweight. However, because USDA appears unwilling to make these necessary changes without Congressional direction, I believe that these changes should be made in statute as part of the 2007 farm bill.

### Milk Income Loss Contract (MILC) program

Because of the inadequacy of the milk price support program as a safety net, First District Association and other members of the Midwest Dairy Coalition argued during the last farm bill debate that an additional program should be established to provide a more credible safety net for dairy producers, and that such a program should be national in nature to provide benefits to all producers. Fortunately, others agreed. The Milk Income Loss Contract (MILC) program that emerged out of the 2002 farm bill has proven to be a very effective safety net, and has helped us move away from some of the contentious inter-regional conflicts that were commonplace in dairy in the late 1990's and the early part of this decade, particularly with regard to regional dairy compacts.

Because of the counter-cyclical nature of the MILC program, the program has proven to be very cost effective. Assistance is only provided to producers when market prices fall below target levels and remains dormant when market prices are strong. Indeed, the MILC program was dormant for much of 2004 and 2005. Without question, our producers would far prefer to see market prices remain strong so the MILC program would remain dormant. However, when prices do fall to low levels, as they did in 2002 and the first half of 2003, and as we are seeing currently, the assistance provided by the MILC program has been critical.

One of the other tools used by Congress to improve the effectiveness and limit the taxpayer costs of the MILC program has been to place a volume cap to limit the benefits to the first 2.4 million pounds of production per operation, roughly equivalent to the production of about 135 cows. All producers are eligible for benefits, but not beyond the 2.4 million pound annual cap. It is important to note that 83 percent of all dairy farms in the Nation are fully covered under this cap. Yet even those that exceed the cap receive great benefits.

The MILC program has proven beneficial to the vast majority of dairy farms in the nation. With regard to the Upper Midwest specifically, there is no doubt that the program has helped us to maintain our productive capacity during low milk price cycles. In that context, it is worth noting that dairy cow numbers in Wisconsin increased in 2005. This is the first time since 1994 that January-December dairy cow numbers in Wisconsin have not shown a reduction. Arguably, the MILC program is one of the factors helping our region turn around.

As we move into the next farm bill debate, it is critical for our dairy industry and our rural communities that the MILC program or a similar type of counter-cyclical safety net program be continued.

### Consistency in our Trade Policies and Tariff Schedules

Gone are the days when the U.S. dairy sector could operate without regard to the global market. The opportunities and challenges of international trade are a reality for U.S. dairy. In that regard, it is critical that we review our trade policies and those of our trading partners, to assure that we have consistent and rationale policies as we move into the future. Specifically, during the Uruguay Round of WTO trade negotiations, tariff rate quotas were placed on imports of traditional dairy import product classes such as cheese, butter, and nonfat dry milk. However, we failed to recognize emerging trends in international trade, particularly with regard to milk protein concentrates (MPCs), and we failed to create tariff rate quotas on those milk protein products consistent with other dairy product classes. As a result, we have seen instances in recent years during which MPC imports to the United States have surged.

In March 2001, a General Accounting Office study requested by Congress determined that MPC imports increased 56-fold from 1990 to 1999, with a near doubling of the MPC imports in 1999 alone. Not only do these import surges affect farmers' milk prices domestically, they also have a cost to taxpayers. In a May 2004 study by the International Trade Commission, it was determined that about 35 percent of the Commodity Credit Corporation stock build up of nonfat dry milk between 1996 and 2002 was attributable to displacement of domestically produced nonfat dry milk by imported milk protein products.

After several years of declines in MPC imports, MPC imports are once again increasing. It is critical that we modify our tariff schedules to place tariff rate quotas on MPCs and casein, as proposed in H.R. 521, introduced by Congressmen Obey and Sherwood. This legislation would not attempt to stop MPC and casein imports altogether. It would merely place commonsense limits to assure that the U.S. doesn't experience major surges of MPC imports again, as we did in the 1990's. The United States is currently the only dairy import-sensitive nation in the world that has not imposed such limits on MPC imports. It's time for us to push for more consistency in our tariff schedules, and to fully recognize and respond to our own market vulnerabilities, as have many of our trading partners.

There is no question that the Upper Midwest Dairy Industry is in the process of becoming more competitive. The Upper Midwest has enjoyed, and will continue to enjoy, many comparative advantages in dairy production and processing. We must work together to achieve the necessary efficiencies to remain competitive, especially with the West and Southwest. This will probably require modifications in traditional premium structures, as well as efforts to provide producers with more accurate information about hauling and transportation costs in an effort to reduce those costs. But as we make these shifts, we need to make sure to keep the interests of this valuable industry and producers at the forefront. We must recognize that Federal dairy policy must play a role in that process. It is our job to insist on policies that treat our region fairly and equitably.

I thank you for this opportunity to testify.

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