Agriculture Committee Testimony
October 27, 2009
Mr. Doug Nuttelman, Dairy Producer
Stromsburg, Nebraska

Chairwoman Gillibrand, Chairman Casey, Ranking Members Johanns and Roberts, other distinguished Senators: thank you for the opportunity to testify on the critical state of America's dairy industry. My name is Doug Nuttelman and I am a dairy farmer from Stromsburg, Nebraska. My three sons and I own and operate Nuttelman Dairy. We milk 185 cows and farm a total of 2,000 acres, which includes corn, soybeans and alfalfa.

I am on the Board of Directors for my cooperative, Dairy Farmers of America (DFA), a national milk marketing cooperative that not only works to pay me a competitive price for my milk but also brings programs and services designed to increase my profit margins. I also serve on the Board of Directors of the National Milk Producers Federation (NMPF). As a national organization, NMPF develops and carries out policies that advance the well being of dairy producers and the cooperatives they own.

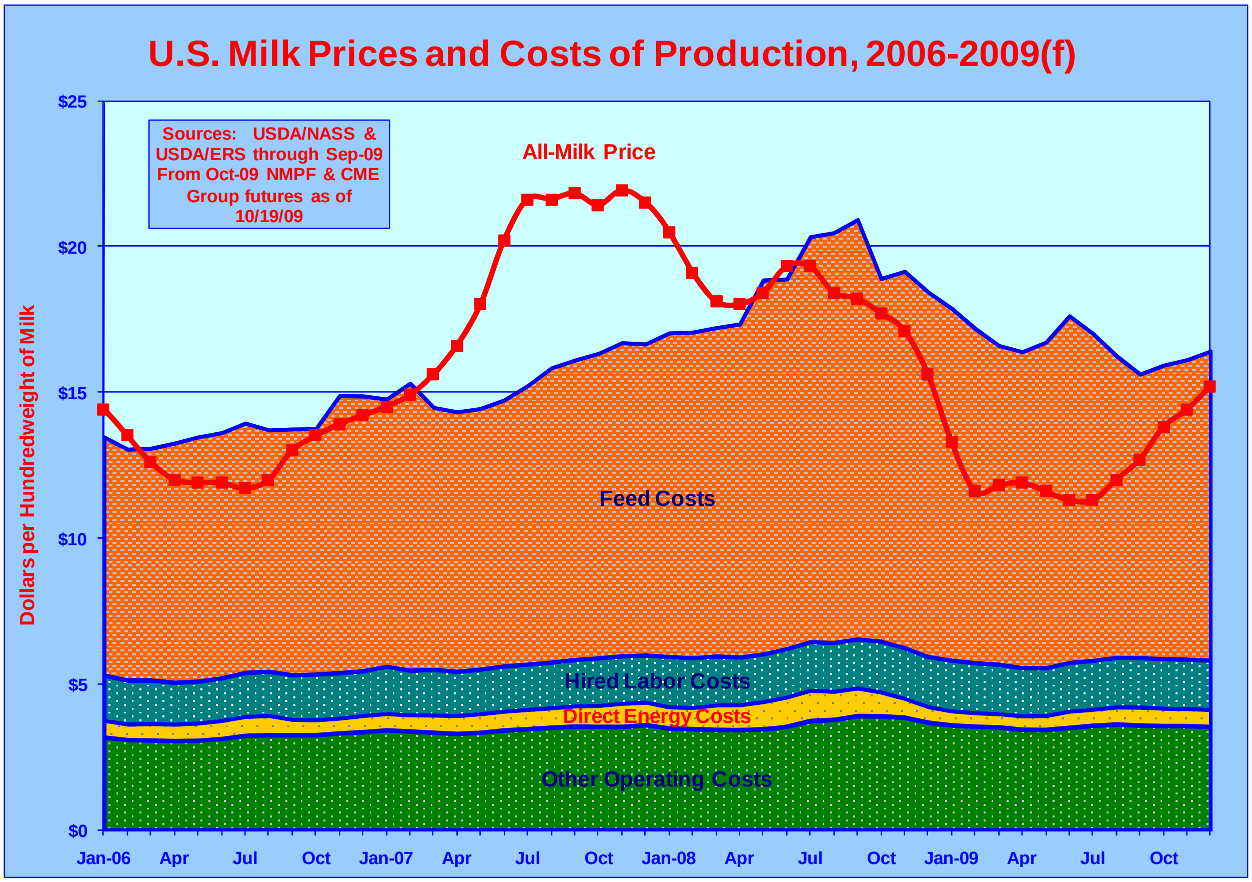
First, I would like to express the dairy producer community's strong appreciation to many of the Senators of this Committee, as well as several other Senators, for their relentless efforts to help dairy producers in these difficult times. During this historically trying time for our industry, we have been fortunate to have a good working partnership with Congress and USDA Secretary Tom Vilsack as we have all worked together to try to find ways to best utilize the 2008 Farm Bill and other programs. These very useful tools have helped to blunt the impact of the crisis currently facing U.S. dairy farmers, but none of these policies alone can resolve the current crisis.

U.S. dairy producers are currently still experiencing unprecedented financial stress caused by historically high input costs. Chief among the basic economic realities now facing the U.S. dairy industry is the transition from being a nearly-exclusive supplier to a relatively mature domestic market into being a major supplier to the growing and increasingly vibrant world markets. Although some may protest this shift, it is a natural evolution in our global economy and one that our industry would do better to embrace than to deny the reality of the world we face today.

This transition will continue to cause larger swings in accessible demand than have been previously experienced, causing significant price movements in an industry where prices are sensitive to even small changes in demand. The traditional instruments for stabilizing prices to dairy farmers, the price support and federal milk marketing order programs, were not designed for, nor are they suited to operate in, this environment. This reduces their effectiveness and exacerbates their negative side-effects on producer income.

Economic Crisis:

U.S. dairy farmers are currently experiencing an unprecedented financial catastrophe. The sudden loss in late 2008 of export market demand equaled about three percent of domestic milk production. This translates into a loss of over 25% of U.S. dairy exports. During January through August this year, the U.S. average all-milk price was $5.10 per cwt. below the U.S. average cash cost to produce milk, as reported by USDA/ERS. As a result, approximately $6.5 billion dollars of dairy producer equity has been lost during these eight months. The chart below demonstrates visually just how extreme the discrepancy between milk prices and input costs is currently and in comparison to recent years.

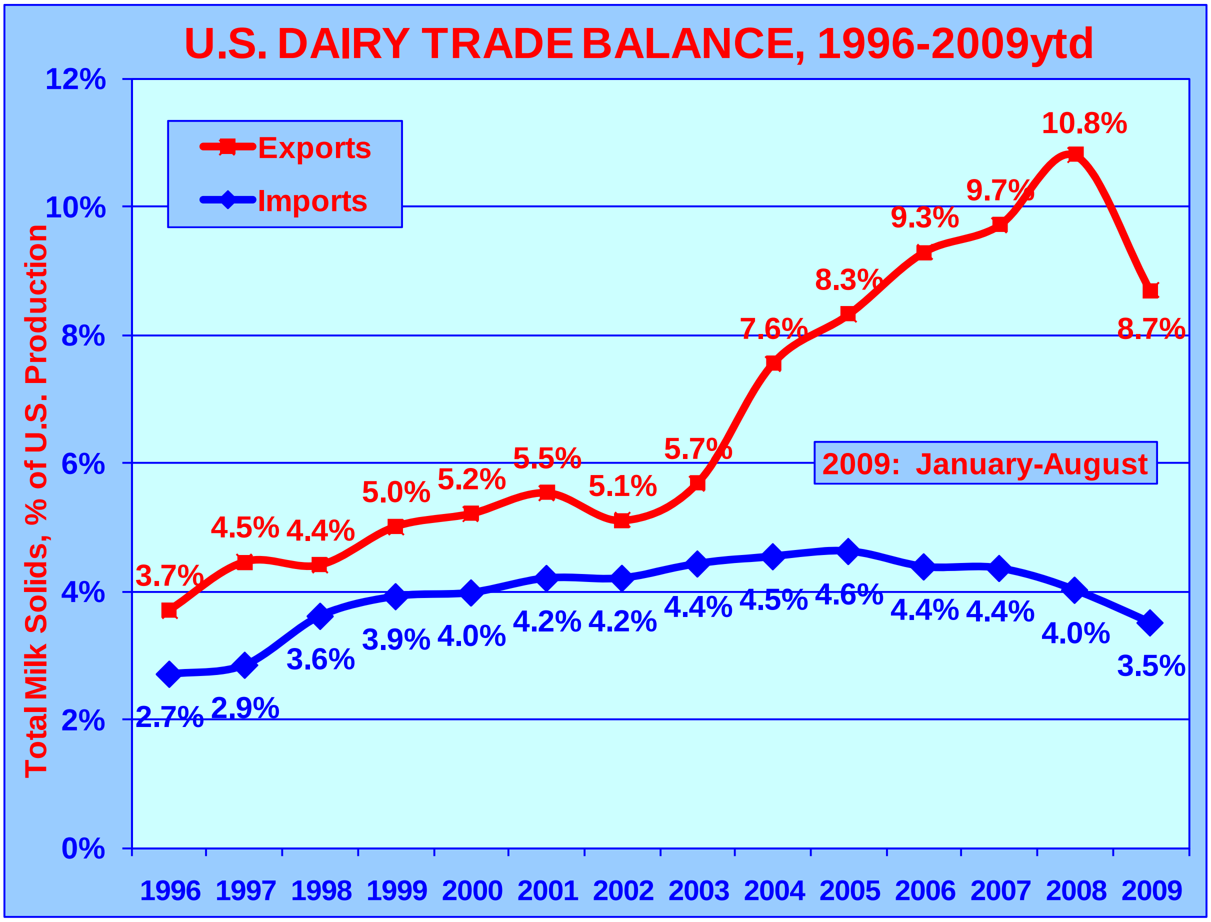


The primary cause for the severely challenging situation facing America's dairy producers is the abrupt decline in export market demand beginning last fall. That was brought on due to an ill-fated combination of the onset of the global economic crisis, combined with a resurgence of milk supplies in Oceania once New Zealand's and Australia's recent drought problems abated. This combination of events contributed to a sudden imbalance whereby global demand fell significantly below the available supplies. Because the U.S. market had gradually increased production to respond to the international market signals being sent in recent years that indicated higher demand for U.S. dairy products, U.S. producers found the rug pulled out from under them when such a significant portion of the market for U.S. milk evaporated in the latter part of 2008.

Some have claimed that the problems we face are a result of a surge in unrestricted imports. The truth is that we have not seen a significant surge in imported dairy products into the U.S. Imports of notable dairy products such as butterfat (up 40% from a relatively small 2008 volume) and cheeses (down 7%) face limitations due to existing tariff-rate quotas (TRQs). NMPF continues to support the creation of TRQs for loop-hole dairy products such as milk protein concentrate (MPC) and casein and it is essential that we zealously enforce importers' responsibilities to comply with U.S. standards and trade obligations; however imports are not the root cause of the problem we are facing. Stepping blindly back from active engagement in trade and from the global market would do more to harm the future prospects for our industry than to help them.

Although I am strong supporter of fair trade not one-sided-trade, it is important to set the record straight regarding the cause of the problem we are now facing in order to develop the best response tools to address it in both the short and long term.

The chart below depicts the U.S. dairy trade balance on a milk solids basis as a percentage of U.S. milk production. The chart shows that on a total milk solids basis in 2009 through August, imports of dairy products are actually down compared to recent years. What is particularly notable – and the largest cause of the current economic crisis facing our industry – is the steep drop in exports from 2008 to 2009, driven by a much lower global demand and by larger supplies from exporters that are moving aggressively to push their own products off their shores at whatever price necessary.



Current Situation

Thanks to the tremendous efforts of Congress, USDA, and the dairy producer community contributing to NMPF's Cooperatives Working Together (CWT) program, the dairy industry is currently poised on the brink of recovery from this disastrous year. Dairy product prices have risen substantially from their previous support levels. There are over 200,000 fewer cows in the national dairy herd than there were at the peak in 2008 - more than a two percent drop. The voluntary, producer-funded CWT program can claim a leading share of the credit for this accomplishment. On October 1, 2009 the third herd retirement program of the year was announced. This is the fifth herd retirement that CWT has conducted in the past 18 months. The two herd retirements in the second half of 2008, plus the two herd retirements so far in 2009, have removed nearly 230,000 cows from the nation's dairy herds and a total of almost 5 billion pounds of milk, helping bring the supply of milk more in line with demand.

In addition, despite the deep recession, demand for dairy products in the domestic market has grown this year, thanks to new product development and a number of industry supported programs, and export demand is slowly returning. The additional measures that Congress encouraged USDA to pursue such as use of the Dairy Export Incentive Program, temporarily raising the dairy product price support, and commitment of dairy products to domestic feeding programs have all contributed importantly to the incremental efforts that have been required to try to address the crisis in the dairy industry this year.

However, it's critically important to understand that it will still take time for dairy farmers to feel significant relief from these positive developments. Higher dairy product prices take time to be translated into higher milk prices. And although they are on the rise, milk prices are still not projected to reach breakeven levels until early next year. Furthermore, reaching breakeven levels will only stop the bleeding. It will take much longer, years in some cases, for dairy farmers to recover the equity that they have lost this year.

<u>Foundation for the Future – Avoiding a Crisis:</u>
What is widely acknowledged within the dairy producer community is that the current situation has redefined dairying. Current dairy pricing programs allow for increased volatility in the industry and don't work for anyone. We need to find ways to bring about stability in markets.

To address the underlying problems that caused this crisis and the many industry factors that have contributed to its depth and protracted nature, we need to focus on solutions that avoid recurrences of the present milk pricing dilemma in the future. We need a combination of approaches when looking at an effective dairy producer safety net.

In addition, we need to work together on these solutions. NMPF, as the national organization representing dairy producers throughout America, can lead in this endeavor and will ensure that we spend our industry's and our government's valuable time and energy pursuing proposals that would appropriately address the situation we are now facing and the environment in which we must operate.

Toward that end, NMPF's member dairy producer cooperatives have built a consensus to analyze and develop a long-term strategic plan for consideration by the NMPF Board of Directors. This multifaceted plan will have a positive impact on the various factors influencing both supply and demand for milk and dairy products and is designed to foster a climate of growth for the industry, while protecting dairy farmers.

A new approach to dairy programs, including seriously reviewing most current federal dairy programs, is necessary to foster a climate of growth for the industry, while protecting dairy farmers.

<u>The Plan:</u>
The key components of this new approach to federal dairy programs are:

1. **Dairy Producer Income Protection (Insurance) Program – Risk Management Tools**

   The purpose of an income protection (i.e. insurance) program is to help dairy farmers survive financially difficult times by paying them an insurance indemnity (payout) when losses occur in their dairy operations. To be successful, the program will need to follow a few important principles:

- Losses caused by either low milk prices or high feed costs need to be covered.
- Producer-paid insurance premiums must be kept low or nonexistent for a historical base of production.
- Coverage should be flexible, and producers may opt to pay for higher or additional coverage.
- The program should be voluntary, national in scope, and open to all dairy farmers, regardless of size.
- The program should not provide incentives to create artificial over-production.
- The program must be easy to access by all producers through a simple application process or through the assistance of their cooperative.

In addition to the Income Protection Program, producers must have available as many subsidized risk management tools as possible to combat future declines in income such as forward contracting with producer protections and supported hedging opportunities.

2. Revamping the Federal Price Support Program

Existing Federal dairy programs intended to serve as a collective safety net to maintain producer viability are seen as inadequate, at best, and detrimental to future industry growth and profitability, at worst. The Dairy Product Price Support (DPPS) program serves to provide a floor under specific dairy product prices and the Milk Income Loss Contract (MILC) program supplements dairy producer income up to a certain threshold when prices fall below a pre-determined benchmark price on fluid milk. Both of these programs have fallen short of expectations during the recent dairy price collapse.

The U.S. dairy industry experiences a structural surplus of nonfat milk solids at prevailing domestic prices, which must either be exported or sold to CCC in the form of nonfat dry milk (NFDM). Under current dairy programs, the U.S. market for imported milk proteins is effectively a part of the world market and hence relatively inaccessible to U.S. suppliers. Accordingly, the DPPSP plays a much larger role for NFDM than for butter or cheese.

Discontinuing the DPPSP offer to purchase nonfat dry milk will require – and allow – the U.S. to market commercially its current excess nonfat solids production every month in the form of products desired by international buyers as well as milk protein products that will reclaim the domestic market currently supplied by imports. In the context of the current surplus situation, this would have placed an additional supply equivalent to 20 percent of domestic production, corresponding to the CCC purchases, on the world commercial markets for NFDM, SMP and milk proteins.

The domestic and world markets are closely linked. Since June 2005, world prices, f.o.b. U.S., have been below the CCC purchase price only about 20 percent of the time, and have averaged just $0.07 a pound below support during those months. The additional volumes of U.S. product that would need to be exported commercially in the absence of CCC purchases would amount to about 15 percent of total world trade. This would likely have the effect of lowering world prices, and U.S. prices, for a temporary period.

However, these lower prices would also be transmitted into lower producer prices for many dairy farmers outside the U.S. For example, Argentine dairy farmers export about 20 percent of their nonfat solids, Australian dairy farmers about 50 percent and New Zealand farmers about 90 percent, compared with about 12 percent for the U.S. These overseas farmers would experience significant price reductions and thereby contribute a substantial portion of the necessary reduction in production and exports needed to bring the world market for nonfat solids, and thus milk production, back into balance. Prices would recover more quickly, U.S. producers would increase total demand by being continuous suppliers and producing commercially demanded products, and there would be no CCC stocks to overhang the market during price recovery. The entire market for U.S. nonfat solids and milk protein products would operate as successfully as the whey protein portion of it currently does.

Discontinuing the CCC offer to purchase component of the DPPSP would increase domestic nonfat solids prices, increase domestic cheese prices modestly and possibly result in a modest decrease in domestic butter prices. The net effect would be higher milk prices received for U.S. dairy farmers. Market prices would be more volatile, but the effect of this volatility on producer incomes would be addressed through income insurance programs, with additional market stability, if desired, provided through industry-funded and operated export assistance for butterfat and additional USDA purchases of fresh cheese for distribution through food assistance programs.

In addition, discontinuing the Dairy Product Price Support Program (DPPSP) would allow greater flexibility in the industry to meet greater demand on various products as well as shortening the periods of low prices by reducing foreign competition domestically (imports) and internationally (exports).

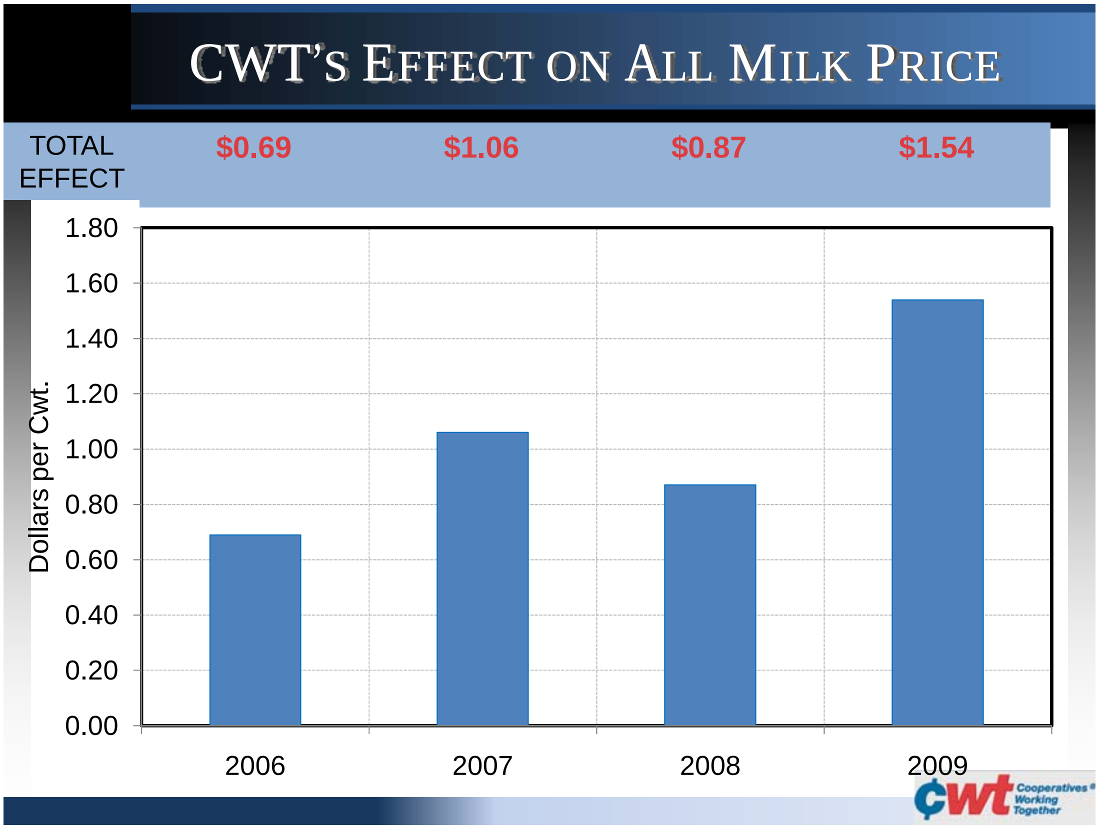
3. Federal Milk Marketing Orders (FMMO) Reform

The Federal Milk Marketing Order (FMMO) Program establishes minimum prices paid to producers in all FMMO-regulated areas through a set of formula-based prices calculated from the market prices of dairy commodity products such as cheddar cheese, dry whey and nonfat dry milk and butter. However, these commodity prices are subject to substantial swings based on relatively minor movement of product in thinly-traded markets; and these swings are transmitted directly to milk prices through the price formulas. This increased price volatility is also reflective of the inelastic demand for dairy products and the ever greater swings in quantities demanded in overseas markets.

FMMO reform must be part of any new direction for the industry. The final outcome of that process must take into consideration various concerns by different regions of the country as well as different roles that the cooperatives play in balancing supply and demand in the United States. The present make allowance system creates a winners and losers scenario that must be corrected going forward, as well as examination of a new price discovery mechanism that is transparent and substantial.

4. CWT: A New Beginning

To assist in maintaining a reasonable supply-demand balance, the industry continues to operate CWT, a voluntary production management program designed to eliminate milk production capacity through the accelerated culling of milking cows and by providing bonuses for shipping manufactured dairy products to overseas markets (thereby reducing the domestic inventory of these products). This program has been highly effective in delivering strong returns for the investment provided by producers, as demonstrated by an independent analysis performed by University of Missouri economist Scott Brown. A chart depicting his analysis of the impact of recent years' CWT programs' effect on the All Milk price is included below.



However, while the CWT program has provided support to producers and to the Federal programs by assisting in maintaining supply-demand equilibrium, it was not designed to be a substitute for a government safety net. The CWT program is also subject to several concerns including "free ridership," and lack of adequate funding because of its voluntary nature. Therefore it is imperative that we evaluate every option to improve the CWT program. At this stage, potential options include the following:

- Evaluate ways to accomplish full participation of all dairy producers
- Partial Herd Retirement or diversion programs
- Bred Heifer Program
- Replacement Heifer Reduction Program
- Export Assistance Program
- Domestic Product Diversification Initiative
- Export Marketing Agency in Common (EMAC)
- Food Bank Assistance

Also, through a program called the Dairy Growth Management Initiative, DFA is evaluating the merits, mechanisms and governance of a congressionally mandated CWT-like program, which we feel may give the dairy sector flexibility in addressing supply issues. This program will be evaluated in upcoming NMPF meetings.

In Closing

We continue to work with industry initiatives such as CWT, in the hopes that in cooperation with USDA and Congress, we can bolster the effectiveness of current programs. Together, it is our hope that these joint actions will help alleviate the economic issues facing us as dairy farmers.

I respectfully ask the Senate Agriculture Committee to be thoughtful in your approach as you consider recommendations to reform or reshape dairy policy in the future. It would be far worse than the current crisis if we put policies in place that would hurt our ability to fulfill the opportunities that we may encounter in the domestic market, as well as the international market. Producers, like me, agree that the more than 70 year-old safety net programs need revamping. It needs to be made more relevant for the future to avoid the conditions we are now experiencing. We are willing to experience some short-term growing pains in order to have a more viable long-term future.

In closing, National Milk Producers Federation, Dairy Farmers of America and I stand ready and willing to assist Congress as you prepare to move forward with restructuring dairy policy in hopes that we will have a sustainable, reliable program for decades to come.

Thank you again for the opportunity to testify and submit my written testimony.