December 2010

Report to the Dairy Industry Advisory Committee from the Dairy Farm Profitability Sub-Committee

Forward

The United States Department of Agriculture (USDA) established the Dairy Industry Advisory Committee in August 2009, under the rules of the Federal Advisory Committee Act (FACA). Agriculture Secretary Tom Vilsack announced the appointment of 17 members to serve on the Dairy Industry Advisory Committee on January 6, 2010.

The purpose of the Dairy Farm Profitability Sub-Committee is to review the issues of dairy farmer profitability. The Sub-Committee will provide suggestions and ideas to the full committee on how USDA can best address these issues to meet the dairy industry's needs.

Committee Charge:

1. What does or what should the DIAC mean by the term "dairy farm profitability"?

2. How does farm profitability relate to financial measurements such as Net Cash Farm Income, Cash Returns, Over Feed Costs, Returns to Operator Equity, Management, and Family Labor, or other measures typically used in farm financial analysis?

3. Is there any single measure that best describes dairy farm profitability, or is it appropriate to use different measures for different purposes?

4. What is the current status of dairy farm profitability, by whatever measures your subcommittee deems most meaningful?

5. Is it appropriate to discuss a national measure, for example the average Net Cash Farm Income, for all US dairy farms or is it necessary to discuss dairy farm profitability measures in categories based on region, size, ownership structure, production method, or the like?

6. What existing federal policies directly impact dairy farm profitability, either in a positive or negative way?

7. What proposed or prospective policies hold considerable promise for improving dairy farm profitability?

The work of this Sub-Committee is in the public's interest because of the dairy industry's importance to the nation's economy. The exchange of views and information between industry representatives and USDA should result in improved understanding of the impact of USDA programs on the dairy industry and contribute to those programs' effective and efficient administration.

The members of the Committee are as follows:

Members	Affiliation
Erick Coolidge	Le-MA-Ra Farm, Pennsylvania – Committee Chair
Paul Bourbeau	Paboco Farms, Inc., Vermont
Edward Maltby	Northeast Organic Dairy Producers Alliance, Massachusetts
Randy Romanski	Department of Agriculture, Trade and Consumer Protection, Wisconsin
Manuel (Ray) Souza	Mel-Delin Dairy, California
Patricia Stroup	Nestle USA, California
Edward Welch	Associated Milk Producers Inc., Minnesota
James (Ricky) Williams	Williams Dairy & Williams Dairy Trucking, Inc., Georgia
Robert Wills	Cedar Grove Cheese Inc., Wisconsin

Executive Summary

The dramatic collapse of the US and world economy in 2008-2009 combined with significant changes in the international dairy market created the 'perfect storm' in the US dairy industry that saw farmgate pay prices plummet to new lows for a prolonged period. While dairy farmers have become accustomed to a 3-4 year cycle of peaks and troughs in pay price and have adapted their business practices accordingly, the prolonged low pay price caused a loss of equity, depletion of credit and severe cash flow problems for farms of every size, production system and location.

In response to this crisis, the USDA used all its available programs to the fullest extent possible to mitigate the cash crunch that farm families were experiencing. In looking to the future of the dairy industry and the rural economy, the Secretary of Agriculture charged the DIAC with analyzing factors that affect dairy farm profitability and farm milk price volatility. This subcommittee was charged with investigating dairy farm profitability; its relationship to standard economic measurement; and the programs and policies that can be used by the Secretary to improve dairy farm profitability.

The subcommittee has developed the following strong recommendations that can directly improve dairy farm profitability and allow farm families to plan for the future. These recommendations are:

- a redefined Milk Income Loss Contract program that includes supplemental insurance for large operations;
- encouraging support of innovation and new products for the export market;
- changes in the somatic cell count that will increase the milk/feed margins and increase export opportunities;
- grants to implement energy efficiencies and green payments to mitigate the high cost of meeting environmental standards;

- Farm Savings Accounts to encourage saving in years of increased revenue;
- improvements to risk management programs to make them more consumer friendly;
- changes in how farm milk prices are determined.

In addition to these recommendations the subcommittee has investigated at length ideas for changes in the milk fortification standards, the impact of growth management programs on farm profitability, the effects of consolidation at all levels of the dairy industry and changes to the Federal Milk Marketing Order.

In the future, with financial burdens being placed on agriculture from non-agricultural inputs and policies in an increasing volatile world economy where global warming has increased extremes in weather, production methods and farm locations will be increasingly determined by where the overall long term economics demonstrate financial stability. The historical approaches of crisis intervention to remedy the extremes in farm profitability are no longer affordable, politically viable or practical within the current economic climate. By identifying different measurements of dairy farm profitability, different factors that can affect it, and by suggesting policies and programs that will have a long term effect on dairy farm profitability, we hope to lay the basis for a strong future for dairy farm families to continue to supply a high quality product at a competitive but fair price. We hope that the outcome of our recommendations will result in policy which focuses on maximizing both dairy farm cash flow and profitability over the long term.

Table of Contents

Definition and measurement of dairy farm profitability

Subcommittee charge

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2. **How does farm profitability relate to financial measurements such as Net Cash Farm Income, Cash Returns, Over Feed Costs, Returns to Operator Equity, Management, and Family Labor, or other measures typically used in farm financial analysis?**

Below are some of the more commonly used ways of measuring dairy farm profitability:

A. **Cash flow Coverage (Liquidity):** Cash flow coverage ratio is calculated by subtracting cash expenses from cash revenues and dividing by current liabilities. Cash flow is the ability to bring in dollars to meet all cash expense obligations including operating expenses, debt services, family living costs, and income tax and social security obligations. Most need a cushion for unexpected opportunities or difficulties. Cash flow can vary dramatically from farm to farm depending on debt structure and family living expenses.

B. **Margin over Feed Costs:** Farm profitability correlates directly with milk prices on the income side and corn and soybean prices on the feed side - represents energy and protein cost. This is an easy and effective measurement for traditional confinement herds that purchase their feed, but does not translate well for dairies that produce their own forage, have significant feed from grazing, or that earn a value-added price for their milk. It does not measure profitability or cash flow adequately.

C. **Adjusted Gross Margin** (adjusted Gross Margin/cwt: Milk income less Cost Of Goods (COGs) less non-milk income) – Gives a measure of what the margins, or returns over variable costs are. It takes debt structure and leveraging out of the equation, and provides a snapshot of how the dairy farm is performing. It can capture the Cost of Production (COP) per hundred pounds of milk or how many hundred weights of milk are being produced by how many cows. More cows will mean more gross income but the expansion may mean more investment and perhaps lower net income.

D. **Return on Assets (ROA) and a Return on Equity (ROE):** Equity is what is owned by the farmer and is calculated by: Assets - Debt = Owner's equity. ROE is calculated by the net income divided by the producer's equity. ROA takes average farm assets, (the average of beginning and ending assets for the period) and divides it by net farm revenue (net revenue (which is a charge for family living (unpaid family labor and management) plus accrual adjustments on livestock and feed inventories, accounts receivable, accounts payable, changes in supplies and prepaids) plus interest (which is the rent paid for unpaid assets)).

E. **Rate of return on assets**: Another indication of profitability when looking at return on assets is for assets to turn in 2.5 years. This relates to the gross income dollars generated per dollar invested. If a dairy has a $1,000,000 invested they need to generate $400,000 of gross income each year. If a 2.5 turn cannot be achieved either there is too much invested, not enough income being generated or the milk price has gotten too low to generate the anticipated income. One of the challenges of using the balance sheet to assess profitability is that dairies with land bases have seen their net worth rise only due to appreciation of land values and then tumble when real estate price drop. This looks good (or bad) on paper but it is not "earned income" which is an absolute critical measurement.

F. **Supply and Efficiency:** If there is enough milk supply dairy farms are profitable and the most efficient will be profitable. With a surplus, prices will remain low until enough cows and operations leave the industry or the world market improves.

G. **Lifestyle supported by a second income:** The biggest growth in livestock farmers is with those that have a second income either from investments, retirement money, spouse's job or part-time work. These new generation farmers are looking to cover costs and perhaps pay the taxes from farm operations, and their assessment of profitability is based more on lifestyle than supporting their family full-time from agriculture.

Subcommittee charge:

3. Is there any single measure that best describes dairy farm profitability, or is it appropriate to use different measures for different purposes?

There is no one way to describe or measure dairy farm profitability and operators will use different criteria to measure it depending on their life goals, size, business structure and location. High prices do not ensure farm level profitability while more modest prices do not condemn farms to a lack of profitability. It is the relationship between revenue and costs (cash flow) that keeps farms in business and the return on equity – or return on assets or net worth - which will ensure the long-term profitability of the farm operation. There are many different production practices and, as with many small businesses, plenty of entrepreneurial initiative and innovation that make a single standard for farm profitability difficult to define. Answers to basic questions on family draw/income for a family where they are both manager and farm worker are answered differently, and farm families may be receiving public assistance for health insurance and food stamps but still see themselves as profitable enough to continue in dairy farming.

In assessing dairy farm profitability, lenders will use one criteria based on their standard loan practice and current government regulations. The USDA and other Federal agencies will choose differing criteria (for example, USDA Rural Development uses tangible net-worth) and for others the concept of farm profitability is to have access to enough milk at a price that ensures a competitive endproduct.

Farms can have positive cash flow but not be profitable. A common example of this situation is a farm that has been in the family for a long time, has no debt against it, and family living expenses are modest. A farm with positive cash flow but poor profitability can survive for some time through peaks and troughs in pay price/margins but is ultimately in a terminal condition. Another generation will not be able to purchase that farm's assets at market values and generate enough income to sustain the operation.

A farm can be profitable and yet have negative cash flow. An example of this situation might be a farm that carries a significant debt load but also has relatively strong milk production to support that debt. When milk prices drop precipitously, the farm operation may not have enough cash flow to

cover operating expenses and debt service. If something isn't done quickly to adjust cash flow, short term debt can accumulate to the point that it pushes the farm into bankruptcy.

For those operations that invest significant capital and employ managers to run their operations, profitability can be defined along standard business criteria around cost of production, return on assets and/or equity.

For those farm families who recognize that in order to cover their living expenses they need to supplement their income, a simple cost of production approach is enough so that the farm operations need only cover their costs because of the enhanced lifestyle benefits from living on a working farm. Many of these farmers are either beginning farmers[1] and/or second career farmers. This is the fastest growing sector of farm operators, with a fifth of all farms having a principal operator that is a beginning farmer. In this sector dairy averages about 17% of commodity production by beginning farmers, second only to poultry at 20%.[2]

For those farms that self-classify as being in the '"agriculture-of-the-middle,"[3] farm profitability can come in many forms and with a mixture of different standard definitions. In good years, profitability may be a return on equity and in poor years it will simply be a question of liquidity. Quality of life and family values will also factor into the continuation of their farming operations.

Subcommittee charge:

[1] USDA's definition of a farm encompasses a large number of different farming operations, and the beginning farmer definition is, likewise, broad. USDA's current definition of a beginning farm is one operated by a farmer who has operated a farm or ranch for 10 years or less.

[2] **Beginning Farmers and Ranchers:** Mary Ahearn, Doris Newton – Economic Information Bulletin Number 53 May 2007. http://www.ers.usda.gov/Publications/EIB53/EIB53.pdf

[3] Over 80% of farmland in the U.S. is managed by farmers whose operations fall between small-scale direct markets and large, consolidated firms. These farmers are increasingly left out of our food system. If present trends continue, these farms, together with the social and environmental benefits they provide, will likely disappear in the next decade or two. The "public good" that these farms have provided in the form of land stewardship and community social capital will disappear with them. From a white paper by Fred Kirschenmann, Steve Stevenson, Fred Buttel, Tom Lyson and Mike Duffy.

4. What is the current status of dairy farm profitability, by whatever measures your subcommittee deems most meaningful?

The dairy industry's progression from fewer cows producing more milk from fewer dairy herds[4] shows no sign of slowing down and the present economy could well speed up the demise of many large and small dairy farms. With the dairy industry relying more on an increasingly volatile world market with many low cost competitors, dairy farm profitability of the future may be based on the most 'efficient' dairies that can produce to meet the expectation of the most current business model within a changing global market.

This economic reality of an extended trough of farmgate prices and milk income/feed margins has ruined the lives of many farm families. The impact on business equity and liquidity for farmers in 2009 was at an unprecedented level that will need many months of higher stable margins in order to remedy the situation. Industry financial experts and anecdotal reports directly from dairy farmers report that over 50% of dairy farms are under lender supervision in 2010 either to manage existing debt or the use of operational lines of credit.[5] Many farms have reached the point where there may be

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[4] *Although the overall number of milk cow operations has declined since 2001, the number of operations with 500 or more head of milk cows has increased. Since 2001, the number of operations with 500 or more head increased by 20 percent, from 2,795 to 3,350 in 2009. The largest size group, places with 2,000 or more head, showed the greatest percentage change from 2001, increasing from 325 places in 2001 to 740 in 2009, a gain of 128 percent. While larger operations were growing in number, smaller operations declined in number. Places with less than 500 head went from 94,665 in 2001 to 61,650 in 2009, a decline of over 33,000 operations, or 35 percent…. In 2009, operations with 500 or more head accounted for 5 percent of the total milk cow operations, 56 percent of the milk cows, and 60 percent of the milk production. USDA NAAS*

[5] Senate Banking Committee, 12/1/10: According to the FDIC, farmers are falling behind on their loans at a 17-year high. Approximately two percent of farm loans are in trouble. Often, the collateral for farm loans is the farm itself, so if a farmer defaults on an operating loan they are at risk of losing their business and their home. "Because of the economy and because some farm loans are in trouble, several banks are telling us that regulators are seeing farm loans as suspect, and discouraging community banks from carrying farm loans. This attitude is hurting rural America without making the banking system safer. What is the FDIC doing to work with banks to make sure farmers have access to credit?" Kohl asked.

no remedy. Feed companies and other vendors are being more pro-active about payment terms, reducing credit because they can no longer carry farms that are unable to cash flow or still have balances from purchases in 2009. Lenders are, in some cases, waiting for the asset of their borrowers to appreciate before calling in the loans. Those that are under most pressure are farms that have:

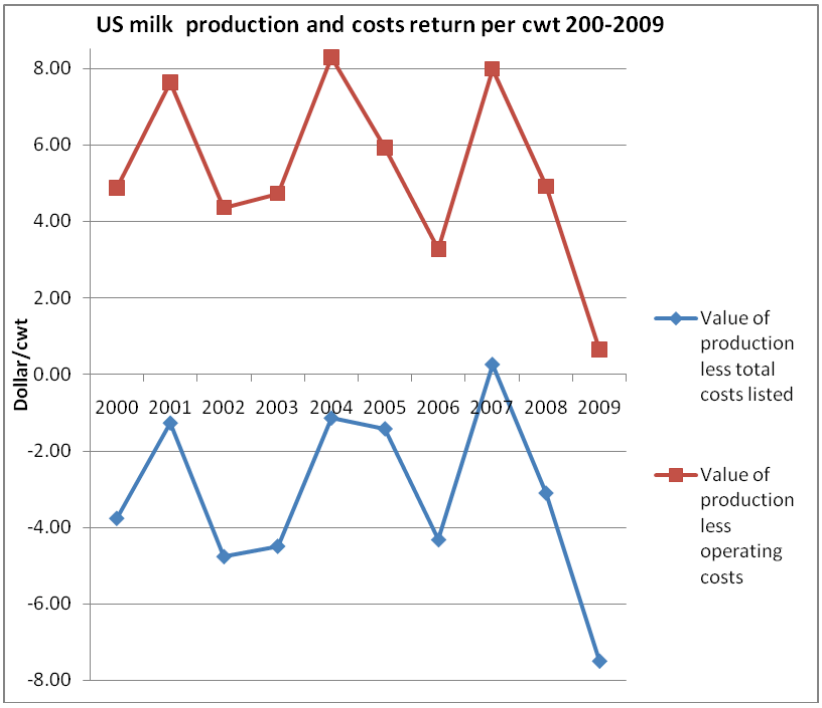
- To purchase feed
- Have highly leveraged assets
- A traditional business model based on cash-flow needs of short peaks and valleys rather than the protracted tough of 2009 followed by low margins in 2010-2011.

In 2011, dairy farmers are faced with major crises because there has not been enough of a prolonged rebound in margins to repair cash flow deficits and pay down payables. This has been compounded by the effects of increased federal regulation on lenders tied with a lack of lender confidence in the face of mixed signals from the dairy industry and anticipated federal policy.[6] Current and projected higher milk prices are being undermined by poorer harvests and greater competition for corn and soybeans from the ethanol and international market resulting in disproportionally high grain prices.

USDA ERS track cost of production[7] and cost of return per cwt for both operating costs and total costs including hired labor, general farm overhead, taxes, insurance and other non-cash items. The chart below clearly indicates the collapse in 2009, but also shows the challenge to profitability using criteria based on balance sheet values during any year.

[6]Senate Banking Committee 12/1/10: Bair said that the FDIC would be open to creating guidelines specific to agriculture lending, similar to what they have done to ease mortgage and commercial lending.

[7]USDA ERS: **Recent Costs and Returns, United States and ERS Farm Resource Regions, New Format and Regions**



Committee charge:

5. Is it appropriate to discuss a national measure, for example the average Net Cash Farm Income for all US dairy farms, or is it necessary to discuss dairy farm profitability measures in categories based on region, size, ownership structure, production method, or the like?

The dairy industry is very diverse in their production practices, location, capital investment, overhead costs and expectations. Tax rates and the value of real estate will vary within the same county and will dictate different business and production methods to cash flow and obtain a return on capital. As illustrated above, it is impossible to find common factors that can be measured to arrive at an average for the whole industry which doesn't necessarily reflect the financial state of the majority of dairy farmers.

In looking at measurements that can be used it is challenging to find one universal tool that can handle the volatility and variability of production and income. A milk price to feed costs has been

an historical easy tool to measure profitability but some recent research has highlighted that in times of great volatility, even this measurement isn't accurate. This research[8] examines the definition, historical pattern, and utility of the milk-to-feed price ratio (MF) as a measure of dairy farm profitability. The MF was generally an acceptable proxy of profitability in an annual sense from 1985 to 2006. The MF was steady at an average of 2.8 from 1985 to 2006 even as average annual milk price in nominal terms increased from $12 to $14/cwt. An alternative proxy for profitability is income-over-feed costs, which is measured in dollars per cwt. . Comparison with an actual profit measure, rate of return on assets, is used to examine the appropriateness of the proxies. The volatility from 2007 to 2009 resulted in MF being a poor measure of profitability over that period. The implication is that MF is not the preferred measure of profitability when a significant change in the pattern of one or both price series occurs. Income-over-feed cost is a better measure of profitability in periods of volatility.

We do have access to more records in a more timely way and an increasing number of models that can highlight different scenarios which can judge everything except the human spirit and fulfillment of goals. Perhaps the only real way to assess farm profitability is by the number of dairies that exit the industry.

Possible variables that affect profitability

Economy of scale

The experience of 2009 has taught us that both large and small operations can be affected by a prolonged trough in pay price and margin over feed costs. Large dairies that expanded based on sound economic projections are economically stressed and, in some case, lenders are waiting for improvement in asset value before calling in their loan. All operations, large and small, have seen a great decrease in equity, liquidity and business confidence in 2009.

[8] Understanding the milk-to-feed price ratio as a proxy for dairy farm profitability: CA Wolf October 2010, Journal of Dairy Science

There are many examples of large and small operations that are efficient and take full advantage of the benefits of their size and location. Small operations may benefit from growing more of their own feed when commodity prices are high and the larger operations whose business model is built on purchased feed will suffer with poor margins. Smaller farms tend to have less debt per dollar of cow and thus can be more resilient in economically challenging times. Smaller farms tend to be more feed self-sufficient and thus more resilient in times of rising feed costs[9]. Smaller farms often can invest in management systems such as managed grazing and organic production which have proven to be profitable management strategies[10].

Large operations have the ability to spread debt service and overhead over high gross income and are able to purchase feed more cost-effectively in large quantities with a greater ability to hedge and protect their risk exposure. Smaller operations may be landlocked, unable to expand and without the asset base to increase debt, and are tied to buying pelleted feed at higher costs.

USDA data shows that despite the increased efficiency and greater average income per acre and per cow generated by smaller farms, the cost advantage of larger enterprises enables them to

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[9] Dietmann, Paul. 2010. A Scan of the Farm-Level Financial Situation at the End of 2009. The Status of Wisconsin Agriculture. [WWW] http://www.aae.wisc.edu/pubs/status/

Bolton, K. and Jenny Vanderlin. 2009. (October). Center for Dairy Profitability. Milk production costs in 2008 on selected Wisconsin dairy farms [WWW] http://cdp.wisc.edu/milk%20production%20costs.htm

[10] Kriegl, T. 2006. Summary of economic studies of organic dairy farming in Wisconsin, New England, and Quebec. Great Lakes Grazing Network. Madison, WI: University of Wisconsin-Madison Center for Dairy Profitability.

Kriegl, T. 2008. Major cost items on Wisconsin organic, grazing, and confinement (average of all sizes) dairy farms. Madison, WI: Center for Dairy Profitability.

Dalton, T. J., R. Parsons, R. Kersbergen, G. Rogers, D. Kauppila, L. McCrory, et al. (2008) *A comparative analysis of organic dairy farms in Maine and Vermont: farm financial information from 2004 to 2006* (No. 851).

achieve much higher net returns. In fact, small and mid-size dairy enterprises (with 100-499 cows) had negative net returns, on average, in 2005.[11] With the largest dairy enterprises providing returns that exceed total costs (including Return On Assets and return to management), those businesses have attracted investment and were expanding rapidly up to 2009. Since the returns to small dairy enterprises do not cover all of their costs, many more small enterprises are leaving dairy farming than are entering. According to USDA ERS data between 1992 and 1997, most capacity expansion at large farms occurred in farms with 1,000-3,000 head. But after 1997, most new capacity at large dairy farms was added on farms with more than 3,000 head, with some going to operations with over 10,000 head. Farmers have discovered ways to more effectively manage much larger dairies in recent years, and the bulk of farm investment is directed at those much larger farms.

While the increase in the size of operations has led to lower costs due to economies of scale and increased gross income to share overhead costs, it also concentrates milk cows and their manure onto a smaller land base. In recent years there have been more measurements of air and water contamination, with increasing amounts of local, state and federal conservation regulation and oversight. As concern over environmental damage grows and global climate change pressure increases, the large dairies will need to be proactive in accessing the benefits of different production methods, for example the measurement of methane produced per cow. The costs of conforming to environmental regulation at large dairies does not yet offset the production cost advantages held by those operations, and regulations have not affected the proportional increase in the number of large dairies.

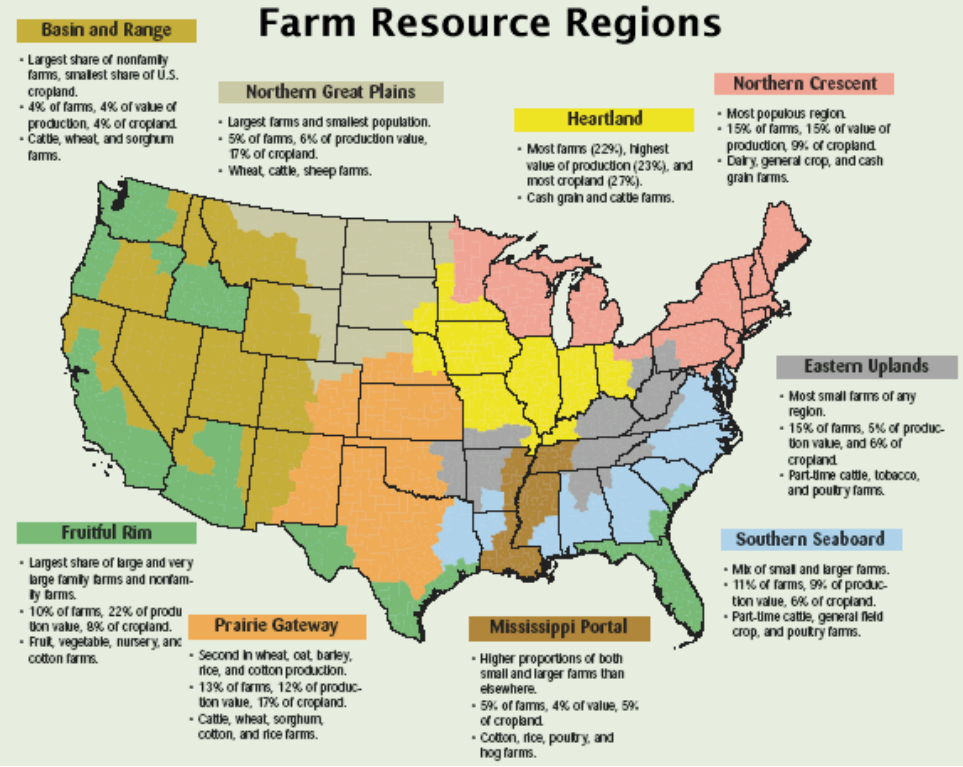
Regional Differences

Regional differences in costs of production and overhead are calculated regularly by USDA ERS. The regions that are used in their data are defined below: "**ERS U.S. Farm Resource Regions:** The U.S. farm sector consists of a highly diverse set of businesses and farm households committed to living in rural areas and engaging in farm economic activities. Since the early 1900's, USDA analysts

[11] USDA ERS 2007: Costs per hundredweight of milk produced fall by nearly half as herd size increases from fewer than 50 head to 500 head, and continue to fall, but less sharply, at even larger herd sizes.

have sought to identify patterns in U.S. farming that might further the understanding of differences in financial performance of farms and the economic well-being of farm households. USDA's Economic Research Service (ERS) constructed regions (called Farm Resource Regions) that depict geographic specialization in production of U.S. farm commodities."

The map below shows the regions geographically:



The table below shows the data from 2009 and highlights the variation in cost of production and overhead costs.

Average milk production income and expenses by region – 2009 – USDA ERS data

Milk production costs and returns per hundredweight sold 1/	Northern Crescent	Heartland	Prairie Gateway	Eastern Uplands	Southern Seaboards	Fruitful Rim
Item	2009	2009	2009	2009	2009	2009
Gross value of production:						
Milk sold	13.36	12.89	12.23	13.65	14.83	12.05
Cattle	1.08	1.43	1.68	1.62	0.93	1.02
Other income 2/	0.84	0.80	0.73	0.89	0.89	0.83
Total, gross value of production	15.28	15.12	14.64	16.16	16.65	13.90
Operating costs:						
Feed						
Purchased feed	5.71	5.65	9.87	6.39	8.79	9.74
Homegrown harvested feed	4.64	4.51	1.12	5.00	2.78	1.69
Grazed feed	0.10	0.09	0.04	0.28	0.16	0.05
Total, feed costs	10.45	10.25	11.03	11.67	11.73	11.48
Other--						
Veterinary and medicine	1.12	1.22	0.64	1.09	0.87	0.71
Bedding and litter	0.40	0.35	0.08	0.18	0.15	0.10
Marketing	0.27	0.30	0.39	0.36	0.47	0.32
Custom services	0.52	0.53	0.47	0.50	0.79	0.44
Fuel, lube, and electricity	0.67	0.60	0.42	0.69	0.64	0.46
Repairs	0.80	0.78	0.37	0.95	0.66	0.51
Other operating costs 3/	0.00	0.00	0.00	0.00	0.00	0.00
Interest on operating capital	0.02	0.02	0.02	0.02	0.02	0.02
Total, operating cost	14.25	14.05	13.42	15.46	15.33	14.04
Milk sold minus operating costs	-0.89	-1.16	-1.19	-1.81	-0.50	-1.99
Allocated overhead:						
Hired labor	1.72	1.45	1.55	1.78	1.83	1.80
Opportunity cost of unpaid labor	3.36	3.18	0.41	5.27	2.16	0.93
Capital recovery of machinery and equipment 4/	3.85	4.33	1.88	6.63	4.04	2.35
Opportunity cost of land (rental rate)	0.03	0.05	0.00	0.11	0.04	0.01
Taxes and insurance	0.32	0.25	0.13	0.29	0.23	0.18
General farm overhead	0.80	0.62	0.21	0.68	0.62	0.35

Total, allocated overhead	10.08	9.88	4.18	14.76	8.92	5.62
	Northern Crescent	Heartland	Prairie Gateway	Eastern Uplands	Southern Seaboards	Fruitful Rim
Total costs listed	24.33	23.93	17.60	30.22	24.25	19.66
Value of production less total costs listed	-9.05	-8.81	-2.96	-14.06	-7.60	-5.76
Value of production less operating costs	1.03	1.07	1.22	0.70	1.32	-0.14
Supporting information:						
Milk cows (head per farm)	109	113	1,064	95	241	522
Output per cow (pounds)	19,528	18,825	18,309	15,346	16,536	19,949

The table above gives a good indication of the regional variation in costs of production and overhead. With a overhead difference of $10.58 per cwt from the Eastern Uplands (W. Virginia, Kentucky and Tennessee) to the Prairie Gateway (Texas, New Mexico, Oklahoma, Kansas) it is no surprise that the average herd size between the two regions varies by 969 cows, with the low overhead region attracting large dairies. It is also evident from the data that the low costs are not only on overhead but also on operating costs.

The data provides a cost per cwt for milk sold that ranges from $12.05 to $14.83 per cwt and a gross income (gross value of milk sold minus total operating costs) ranging from a negative $1.99 per cwt to a negative $.50 per cwt. A difference of milk price of $2.78 per cwt yielded a $1.44 difference in gross profit.

Feed costs varied only by $1.50per cwt and labor cost were within $0.50 per cwt for each region.

The largest difference between the various geographic regions is with capital recovery of machinery and equipment. USDA ERS defines this item as “Capital recovery cost is an estimate of the cost of replacing the capital investment in machinery and equipment that is used up in the annual production process, plus interest that the remaining capital could have earned in an alternative use.”

While this is a non cash use, it is critical for the long term profitability of the operations and a difference of $4.75 per cwt is significant.

It is evident from this data that, based purely on financial data, any new dairy operations would be set up in Prairie Gateway (Texas, New Mexico, Oklahoma, Kansas) as a low cost/low milk price area with a profit of $1.22 per cwt gross income minus operating cost, or in the Southern Seaboard (Virginia, North Carolina, South Carolina, Georgia, Alabama) higher cost but also a milk deficit area with a high milk price and a gross income minus operating costs of $1.32 per cwt.

International Markets

Benefits of World Trade

Global demand for dairy products is increasing driven by income growth and changing diets in developing countries. That has opened up new opportunities for exports and also increased the correlation between farmgate prices in different countries. We live in a market economy and ninety six percent of the world's population, live, purchase and consume products outside of the United States. The number of middle-class consumers in emerging markets is projected to triple by 2030, reaching one billion in that year. These consumers will demand more animal proteins for their diets, including dairy products. For example: China has 20 percent of the world's population and growing per capita income and its' dairy product consumption is expected to increase by about 10 percent annually in the coming years. Dairy product consumption is expected to grow by 4 to 9 percent annually in Southeast Asia, depending upon the country, and Mexico, Algeria, and Saudi Arabia have recorded increases in dairy product consumption and are open to dairy imports. Mexico, in particular, will continue to represent a growing market for U.S. dairy exports.

Ample evidence has been presented to the committee that the U.S. is uniquely positioned to take advantage of these opportunities. Expanding existing market access and opening new markets under future trade agreements will significantly boost U.S. agricultural export sales. The US needs to be proactive in marketing more profitable value-added product as well as bulk commodities on the world market to negate any adverse effects on farm profitability from expansionist World Trade

Organization (WTO) policies. The export market has been especially important to the U.S dairy industry price recovery in 2010 and should be supported to the fullest extent, especially as one of every three US acres is planted for export.

Challenges of World Trade

Growing world demand, slow growth in global milk production, falling government inventories and fewer export subsidies pushed prices on the world market to record highs in 2007 and 2008. The economic crisis combined with a rebound in global milk production in late 2008 pushed prices down in late 2008 and early 2009. Prior to 2007, there was almost always a surplus of dairy products in the US or the EU, which generally offered a buffer against higher prices. Since 2007, prices have become more volatile, not just in the US, but worldwide. With the dairy industry becoming increasingly globalized and complex, higher volatility in output and input prices, and new sources of demand growth (exports, functional nutrients, and pharmaceutical products), the existing models for predicting world demand may over simplify the situation and make predicting demand and supply challenging.

WTO may level the playing field with other countries that subsidize their farms much more than the US, but what will be the effect of future negotiations on the US margins? The impact of WTO tariff commitments and the funds required to pay damages if the US were to increase its tariff barriers beyond agreed levels makes isolation of the domestic market unlikely. Additionally, a protectionist approach that isolates the US markets and significantly raises prices would isolate the greatest growth opportunities for the US dairy industry.

If available funds are used to stimulate and support the manufacturing of products the world will buy, the world market can become a dependable growth sector for US dairy whether supply is in surplus or deficit. The US can be a player on the world market if they react to world trends rather than expecting the world market to be tailored to US current manufacturing capacity.

Impact of non-dairy economics, policy and trade on profitability

Market Concentration

Dairy markets are increasingly becoming dominated by one or a few large firms. Concentration has been increasing at all levels of the market chain. Farmers have fewer potential buyers for their milk; in some regions only one. Bottlers often have considerable market power and also face few potential suppliers of milk. Some manufacturers of dairy products have significant market share in their product categories; appear to have discretion setting prices; and have bargaining power with suppliers. Distribution and retail channels are also increasingly dominated by a few firms.

Market power, whether deriving from monopolistic power, product differentiation or collusion, conveys the opportunity to control supply and raise price. Market power may be one of the explanations for the widening gap between farm level and consumer prices. During the sub-committee's deliberations, the US Department of Justice was studying issues of market power in food markets. Dairy was one of the markets that received close examination. The sub-committee defers to the testimony and analysis at those hearings for details about concentration levels, trends and their effects.

Ethanol mandate and subsidies

The use of corn in the production of ethanol increased when the George W. Bush Administration enacted energy policies requiring stepped-up biofuel use in the nation's fuel supply to reduce dependence on foreign oil. Domestic ethanol production in 2010 is running at a record pace as high fuel prices boosted profit from blending the corn-based additive in gasoline. Production is expected to increase further in 2011, assuming Congress continues a federal subsidy that pays fuel makers a 45 cents-a-gallon tax credit for using ethanol.

US ethanol production during the first eight months of this calendar year totaled 8.62 billion gallons, up 24 percent from the same period in 2009, according to Energy Department data. At that pace, production for the full year will reach nearly 13 billion gallons, an all-time high. During the 2010-11 marketing year, the estimated 4.8 billion bushels of corn used by ethanol makers would account for 34 percent of US supplies, according to USDA data. Five years ago, the ethanol industry used 1.6 billion bushels, or 12 percent of supplies.

For those operations that buy their feed, the increase in the price of corn, partly caused by the demand from the ethanol industry, has had a dramatic effect on their costs of production, as the pricing of other commodities are linked to the price of corn.

Estate taxes - Federal estate taxes will be a factor if the farm stays in business or is sold for development. A high exemption from paying estate taxes of $5 million or even exempt production agricultures farms from paying any estate taxes if they stay in production would benefit production agriculture, especially those 'ag in the middle' operations with a large land base.

Labor – The issue of qualified and committed farm labor is an increasing problem, especially as production methods are becoming more sophisticated; so much so that interest in robot milking has increased especially among herds from 50-200 cows. The ability for dairy farm operators to compete on the labor market and provide a compensation package that will reflect the level of responsibility and work is directly related to the dairy farm profitability. USDA ERS data show that in 2000 the cost per cwt for hired labor was $1.14, and that has increased to $1.71 in 2009. The price received for milk in 2000 was $12.63/cwt and in 2009 it was $21.81. Health insurance in an occupation that is physically demanding and prone to accident is essential and many farm operators are finding it difficult to find affordable and adequate health care (health care without a $20,000 deductible).[12] Traditionally, a source of labor for dairy farm work has come from immigrants, whether under government plans or those immigrants that are able to work legally in the US.[13] Increased enforcement of regulations and uncertainty about immigration reform has been an issue with many dairies that had previously used qualified and motivated immigrant labor.[14]

Climate change legislation will also affect the bottom line for dairy farmers going forward. With increasing state and local conservation and federal regulation and oversight, the costs of meeting

[12] There are a rising number of farm families that are on Badgercare in 2010, which is WI state health care program. – WI Secretary of Agriculture, Trade and Consumer Protection

[13] **Farm Labor Shortages and Immigration Policy - Linda Levine,** Specialist in Labor Economics, Comgressional Research Office, November 9, 2009

[14] "Vermont dairy farms count on illegal immigrants" By Wilson Ring, AP Staff Writer, May 13, 2009, http://www.immigrationworksusa.org/uploaded/file/051309Vermontdairyfarmscountonillegalimmigrants.pdf

these regulations and the time dealing with regulators who lack experience with farm operations will increase. Within an increasing urban population the competition for scarce water resources will increase the cost, especially in those areas that rely on irrigation.

Disappearance of infrastructure – as the number of dairy farms in any one area decrease there is a corresponding decrease in the economic viability and profitability for service providers. As these service providers disappear, there is an increased overhead for maintenance, repair and other input service costs, plus the availability of production advisors.

Federal Regulation of lenders – The increased federal regulation on lenders and the uncertainty of commercial lenders about what is expected of them from regulators, has increased the difficulty of obtaining loans, refinancing and lines of credit.[15] At a time of decreasing asset value in real estate and a depressed market for dairy cows, dairy operators have been repeatedly placed in the high risk category that requires an increased loan to debt ratio and a higher projected cash flow to pay debt service.

Acts of God affecting supply internationally can't be predicted and are not something the Secretary has any control over, but it has a significant impact on the world supply and demand, so should be a factor in any risk management plan.

Sub Committee charge

6. What existing federal policies directly impact dairy farm profitability, either in a positive or negative way?

7. What proposed or prospective policies hold considerable promise for improving dairy farm profitability?

Traditionally, dairy policies have been designed to improve farm operator' incomes by influencing the prices that producers receive for their milk. For example, price support programs were designed to raise the minimum prices received by all producers—regardless of herd size. But with

[15] President Bill Clinton December 10, 2010, CNN

wide disparities in production costs, prices that might cover costs for midsize farms would yield large profits and very strong expansion incentives for large dairies. Any across-the-board (particularly if it is artificial) improvement in milk price will improve overall profitability per unit at any given time. Because the input costs per unit for large farms and/or those with less onerous expenses are generally less than those for small farms and/or those with specific expense disadvantages (i.e. environmental pressures, urban encroachment costs, etc), nationwide milk price improvements will enable those farms with a competitive advantage (size or business model) to become even more profitable. This, in turn, enables expansion and more milk supply from those farm demographics that are already generally successful. A wholesale increase in milk price will generally not help those dairy farmers who are not already fundamentally well-poised to survive for the long-term.

Suggested programs to assist farm profitability

Growth Management

Although the underlying causes of milk price volatility continue to be debated, analysis reveals it has been incrementally increasing since the early 1990s. A prolonged period of volatility in 2008 and 2009, however, brought this trend to the forefront. The inordinate price swings during this period contributed to inadequate income for dairy farmers.

The dairy industry needs a new mechanism to reduce boom-and-bust cycles, with the objectives of reducing variation in milk prices and farm income. Reputable studies reveal a properly designed and managed growth management plan could do just that.

To be effective, the plan must first allow for production growth and enable new producers to enter the industry. Both are needed for the U.S. to maintain a viable dairy complex. The plan must also reduce milk price volatility; have little impact on import and export activity; be national and mandatory; and reduce the cost of government-led counter-cyclical dairy programs.

If the program meets these criteria, it would reduce volatility without artificially raising the cost of milk. Through this inherent stability, there would be more long-term transactions between dairy producers and manufacturers. This should reduce the occurrence of product reformulation and menu displacement with non-dairy alternatives that may be less costly.

Changes to the FMMO to reflect competitive prices, greater transparency and costs of production

Reform of Federal Milk Market Orders (FMMO) has been recommended by commissions dating back at least into the 1960s. Inefficiencies, inequities and distortions caused by the market orders have been well documented. On the other hand, the market order system has been an important source of information about milk and dairy product uses and prices. Market orders have also been tasked with preventing abuses of market power, but they have not been very successful in that area. Initially designed to assure a supply of fluid milk, market orders all provide a premium price on beverage milk. This differential was expected to increase the overall value of milk by taking advantage of what was perceived to be more inelastic consumer demand for fluid milk than for other dairy products. Farmers participating in a particular market order were expected to receive a blend price that averages the price of milk used in various forms. Changes in market conditions make the assumption of inelastic demand for fluid products questionable. Econometric analyses show relatively high price elasticity especially for reduced-fat milk categories. These results likely reflect the increasing number of substitute beverages including fortified waters, juices, coffees, soda, teas and soy and almond "milks". Over time, per capita consumption of fluid milk has shown a large and steady decline.

Since 2000, classified pricing systems have been based on the prices of narrowly-defined end products. The prices are discovered through surveys of processors. The particular products selected for the formulae are those that are traded on the Chicago Mercantile Exchange (CME) and survey prices track the exchange prices closely with a time lag. Dairy contracts on the CME and predecessor exchanges like the Green Bay Cheese Exchange have small volume and have a documented history of price manipulation. Price movements on those markets often do not seem to track fundamental market conditions for the particular narrow commodities or for dairy products in general. Suspicion of market prices among farmers and processors is widespread. Survey prices have been subject to error and have sent incorrect signals to the market. To the extent that the prices of these narrowly defined product

categories are more volatile than supply and demand conditions in the broader market, the end-product based classified pricing system transmits the volatility into the broader milk price.

Basing classified pricing on prices of individual products has also been criticized for distorting production decisions. Formulae attempt to reflect the cost of converting milk into the end products. Production costs including costs of labor, energy, and ingredients are not static. Formulae should be adjusted frequently to reflect real processing costs, but the market order system does not permit easy revisions. Formulae also provide a make-allowance, enabling profitability for processors whose costs are similar to those presumed. Processors of the index products have relatively low uncertainty, compared to processors of other dairy products, because they know that their milk costs will be consistent with the end product price. This biases the market toward production of those commodities. Although market orders establish minimum prices that need to be paid to individual farmers, those prices only apply to farmers that are pooled in the order and only apply to farmers supplying proprietary firms. Cooperatives are able to re-blend the prices among suppliers and even transfer premiums to farmers outside the market order. These funds become tools for reinforcing and extending market power. Ironically, while the market order system was conceived to assure consumers a supply of fluid milk, it has evolved to exclude milk that could be available for bottling. And while it was engendered to establish minimum prices for farmers, fewer and fewer farmers are assured of receiving that minimum. Currently, ten regional market orders exist, each with its own rules. These create a labyrinth for milk handlers to negotiate and provide advantages to companies who understand and can take advantage of different market regulations. Regional market orders have different levels of premiums on beverage milk and different percentages of milk that are used in different classes. Farmers associated with different orders receive very different prices as a result. Generally, milk prices are higher in the southern and urbanized regions of the country.

Farm Savings Accounts (FSAs)

Farm Savings Accounts are a program through which farmers can defer taxable income in profitable years by placing funds in a qualified account. This tool is designed to reduce the level of

investment in expansion and other capital projects that are made with the objective of avoiding tax liabilities under current tax law. Funds that have been deposited will be available to assist producers at their discretion. Funds, including interest, withdrawn from the farm savings accounts would be taxed at the rate applied in the year in which the funds are withdrawn. An important benefit of the farm savings accounts is that producers will have a reserve cushion of cash available to weather low margin years. The challenge for the dairy farmer is to have a year when there is money to deposit in a FSA, as it will take a few years of good margins to replace the loss of equity, pay down vendor and bank debt and improve cash flow from their experience in 2009.

The concepts behind FSAs are not new. Variations that included matching funds from the government were explored as potential policy solutions in the 2002 and 2007 Farm Bill debates as alternatives to loan and other traditional crop programs but were ultimately rejected by Congress. Several studies have examined the potential use and impact of FSAs on dairy farms.[1617] The studies found that most farms were eligible for at least one deposit in five years and the model analysis estimated average investments at the end of the five years to be between $9,726 to $42,289 depending upon the income measure used to determine deposit capabilities (i.e. cash balances, net earnings, cash flow coverage margin, adjusted investment).

A 2006 ERS study, "Whole-Farm Approaches to a Safety Net[18]," examined farm savings accounts, including Farm and Ranch Risk Management (FARRM) and CCAs, and revenue insurance as options to provide a "whole farm" safety net to US agricultural producers. The report points out farm savings accounts are an attractive option because they could be applied to more agricultural enterprises rather than being restricted to the traditional program commodities.

[16] Enahoro and Gloy (2006) analyzed five years (1997-2002) of data from 142 New York dairy farms to determine the effectiveness of FARRM and CCA accounts.

[17] Overview of Farm Savings Accounts (FSA) Alternatives *Michael Boehlje, Joshua Detre, and Allan Gray, Department of Agricultural Economics, Purdue University 2007*

[18] Dismukes, R. and Durst, R. "Whole-Farm Approaches to a Safety Net." 2006. USDA-ERS.

Counter Cyclical Payments

Milk Income Loss Contract (MILC)

The Milk Income Loss Contract (MILC) program began with the 2002 Farm Bill. It was designed to replace the money lost to New England farmers when Congress declined to renew authorization for the Northeast Dairy Compact.

Payments have been triggered when the Class I price in Boston has fallen below $16.94 per cwt. (the old Compact Class I price). Currently, the base payment rate is any positive difference between $16.94 and the Class I milk price at Boston, times 45%. (*This* 45% is the share of Class I milk in the New England market that lost the Compact premium.)

There is also a "feed cost adjustor," which can only increase the payment. When the price of a cwt. of dairy feed rises, say 10% above its target of $7.35/cwt., the $16.94 target for Boston's Class I price is adjusted up by 10% x 45% = 4.5%. (*This* 45% is feed's rough share of milk costs.) This raised the target in earlier months, but is not now projected to increase any actual payments.

Payments under the program are limited by production: currently, producers are eligible to receive payments on up to 2.985 million pounds per fiscal year. Larger producers can choose the month for which they want to start receiving payments; after that, they receive payments for all months until they reach their cap. Months with no payment don't count. One criticism of this program is that the cap unfavorably benefits the smaller operations. The Table below shows data on the difference in the amount of dollars received in different sized herds. Larger herds can generally receive more dollars per year from MILC if they choose the months with the highest pay-out to apply for the money.

ESTIMATED MILC AND DPIPP PAYMENTS FOR SELECTED SIZE DAIRY FARMS 2000-2009 – Robert Wellington, AgriMark cooperative

	PAYMENT RATE	100 COW FARM	1,000 COW FARM	10,000 COW FARM
	MILC	MILC	MILC	MILC
2000	$ 0.96	$19,200	$23,040	$23,040
2001	$ 0.19	$3,800	$4,560	$4,560
2002	$ 1.21	$24,200	$29,040	$29,040
2003	$ 1.09	$21,800	$26,160	$26,160
2004	$ 0.22	$4,400	$5,280	$5,280
2005	$ 0.01	$200	$240	$240
2006	$ 0.61	$12,200	$14,640	$14,640
2007	$ 0.01	$200	$240	$240
2008	$ -	$0	$0	$0
2009	$ 1.15	$23,000	$34,500	$34,500
Total		$109,000	$137,700	$137,700

Despite modestly higher Class I price projections in early 2011, MILC payment projections are up with rising corn and soybean futures. National Milk Producers Federation projects MILC payments averaging nearly 40¢ per month for the 19 months beginning with January 2011.

It is worth noting that all the projected MILC payments for FY 2011 and FY 2012 are based entirely on the feed cost adjustor that was added to the program in the last Farm Bill. That is, there are no months in which the Boston Class I price is projected to be below the base target of $16.94. With this adjustor, which raises the Class I price target when feed costs are particularly high, the MILC program is a hybrid of milk price and milk-feed margin protections.

Benefits and Proposed Modifications to MILC Policy

The MILC program assists many farmers in economically challenging times. MILC has provided significant assistance to producers across the United States. It is important to note that all regions of the country have benefited from the MILC program in substantial ways. In addition to the Midwest (e.g. Wisconsin received a mean of $13,300.00 per herd) and Northeast (e.g. New York

received a mean of $13,400.00) receiving substantial MILC payments in 2009, Western and Southern states also received substantial benefits (e.g. California received a mean of $47,000.00 per herd and Georgia received a mean of $26,470.00 per herd)[19]. If MILC had been replaced with the Dairy Producer Margin Protection Program (DPMPP) in Foundation for the Future (FFF) during 2002-2009, an average farm with a 100 cow herd would have received $59,000 less in indemnity payments[20].

Although MILC is a program that has helped a lot of farmers during challenging times, some larger producers criticize the MILC program because of the production cap. It is important to note, however, that seventy six percent of herds nationally have fewer than 100 cows[21] and thus most US farmers would not even reach the production cap.[22] If there were no cap on payments and no growth management in place so that payment levels were completely parallel to production base, the largest 2.5% of the producers would get 47% of the payments.

There is also a myth that smaller producers are somehow less "efficient". However, there are too many factors which can influence economic vulnerability over the long term to assume that the MILC program keeps farmers in business that would otherwise go bankrupt because of their size. Smaller farms tend to have less debt per dollar of cow and thus can be more resilient in economically challenging times and they tend to be more feed self sufficient and thus more resilient in times of rising feed costs[23]. Smaller farms often can invest in management systems such as managed grazing and organic which have proven to be profitable management strategies.[24]

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[19] Calculated from data on MILC payments by state and number of farms by state from USDA

[20] Midwest Dairy Coalition—Calculations assume 20,000 lb of annual production per cow for all farms and years; farms would only take the fully-subsidized base program for the DPMPP and no growth management; no growth management

[21] The cap becomes operable at ranges of 130-180 cows depending on production levels.

[22] http://www.nass.usda.gov/QuickStats/Create_Federal_All.jsp

[23] Dietmann, Paul. 2010. A Scan of the Farm-Level Financial Situation at the End of 2009. The Status of Wisconsin Agriculture. [WWW] http://www.aae.wisc.edu/pubs/status/

The Farm Profitability sub-committee recommends that in the 2012 Farm Bill, the MILC program or a program similar to MILC be enacted and suggests that the current trigger be replaced with an all milk income/feed costs margin trigger. This will more accurately reflect the cost of production. The table below, prepared by Larry Salathe, USDA, gives an indication of how payments may vary under an all-milk/feed cost margin trigger.

MILC Payment Rates Under Various Feed Costs								
	Case I	Case II	Case III		Alt. I		Alternative II	
MILC Trigger	16.94	16.94	16.94		16.94		16.9	16.94
Feed Cost	7.00	7.35	9.35		9.35		7.35	9.35
MILC Feed Trigger	7.35	7.35	7.35		7.35		7.35	7.35
Trigger with Feed								
Cost Adjustment 1/	16.94	16.94	19.01		21.39	3/	16.94	19.01
Class I Boston Price	15.00	15.00	15.00		15.00		15.00	15.00
Adjusted Trigger								
minus Boston Price	1.94	1.94	4.01		6.39		1.94	4.01
MILC Payment Rate 2/	0.8730	0.8730	1.8064		2.8747		1.94	4.01
1/Equals 45 percent of the percentage increase in feed cost above 7.35 times 16.94								
2/Equals 45 percent of the difference between the adjusted trigger and the Boston Class I price.								

Bolton, K. and Jenny Vanderlin. 2009. (October). Center for Dairy Profitability. Milk production costs in 2008 on selected Wisconsin dairy farms [WWW] http://cdp.wisc.edu/milk%20production%20costs.htm

[24] Kriegl, T. 2006. Summary of economic studies of organic dairy farming in Wisconsin, New England, and Quebec. Great Lakes Grazing Network. Madison, WI: University of Wisconsin-Madison Center for Dairy Profitability.

Kriegl, T. 2008. Major cost items on Wisconsin organic, grazing, and confinement (average of all sizes) dairy farms. Madison, WI: Center for Dairy Profitability.

Dalton, T. J., R. Parsons, R. Kersbergen, G. Rogers, D. Kauppila, L. McCrory, et al. (2008) *A comparative analysis of organic dairy farms in Maine and Vermont: farm financial information from 2004 to 2006* (No. 851).

3/Equals 96.5 percent of the percentage increase in feed cost above 7.35 times 16.94
Under Alternative II the MILC Payment Rate equals the difference between the adjusted trigger and the Boston Class I price.

MILC could also be modified to more adequately reflect feed costs. Margin should be calculated based on corn, soybean **meal** price (rather than soybean grain price) as in the Foundation for the Future proposal.

Region-specific feed adjuster margins could also be explored (e.g. corn silage is used more frequently than alfalfa silage in some regions of the country).

MILC payments need to be timely rather than delayed by several months. The current delay is mainly caused because information from NASS surveys is used to calculate the feed components in the feed adjuster. The delay in payments could be shortened if corn and soybean prices were based on the CME prices. The alfalfa silage could be replaced with corn silage so as to also use CME prices. Projected NASS prices could also be used instead of average actual NASS prices. The potential discrepancies could be refined over time. Generally, the projected prices are close to the actual average NASS prices, although the discrepancies are higher more recently with more volatile prices[25].

The MILC program could be modified to give greater assistance to larger producers. The MILC program should give producers the option of purchasing additional insurance. This would enable producers to buy margin coverage on milk production levels above 2.985 million pounds. There could also be an option available for differentials higher than the 45%. These changes would make the MILC program somewhat similar to Crop Revenue Coverage (CRC) insurance that has been available to farmers for a number of years. As of 2009, 51% of corn and soybean acres in Wisconsin were covered by CRC insurance. CRC premiums are subsidized through the USDA Risk Management Agency but are still higher than premiums for other crop insurance programs. Despite that, farmers have accepted CRC because it offers good coverage, flexible terms, and is a relatively easy program to

[25] Milk Income Loss Contract (MILC) Program [WWW]
http://future.aae.wisc.edu/alliance/2012/MILC_full.pdf

understand. There could also be additional options given to farmers who exceed the cap if they would like to spread out their payments over a longer period than three months.

The Dairy Product Price Support Program

The Dairy Price Support Program (DPSP) was authorized under the Agricultural Act of 1949 and has been reauthorized by subsequent Farm Bills. The Act gave the Secretary of Agriculture discretion to establish a support price that would cover 75-90 percent of "parity" (a measure of farmers' purchasing power). In 1981, Congress suspended the requirement that the Secretary establish support prices within that range and, in 2008, the parity language was dropped altogether.

The 2008 Food Conservation and Energy Act (FCEA or "Farm Bill") also altered the purchase price targets, replacing a support price for milk with support prices for commodity cheddar cheese, butter and nonfat dry milk. This altered program was titled the Dairy Product Price Support Program (DPPSP). USDA is obliged to buy any and all quantities of eligible product offered at the announced purchase prices. Typically, any such product so acquired will either be sold back into commercial markets at the sellback price or will be made available for use in a food assistance program (possibly under Sec. 416(b) or one of the domestic programs, such as TEFAP or School Lunch).

To the extent that manufacturers take advantage of this guaranteed price, market prices should not fall below the government offer price, or at least not by very much. In practice, sellers show some reluctance to sell cheese and butter to the government. USDA issues standards for product purchases that do not match the standards required by other market buyers and payment terms are outside of industry norms. In January 2009, wholesale cheddar cheese prices were six to seven cents per pound less than the USDA purchase price for three weeks without generating sales to the CCC. USDA should examine this market resistance and make program changes that minimize reluctance to participate.

The support prices assure manufacturers of these commodities that they will have a market for the products. Also, prices of these products are the foundation for federal order milk prices, so the effect of purchases is widespread. Some analysts suggest that the support price program has resulted in

too many resources being directed toward production of the targeted commodities compared to other products that might have broader market opportunities. If the distortion leads to inefficient allocation of resources in dairy markets, it would reduce returns to farmers in the long run.

Although Congress specified a fixed support price for milk from 1981 to 2008, when it passed the Food, Conservation, and Energy Act of 2008 it changed specifications of commodity support prices from "shall be" to "shall be no less than". In so doing, the Act created authority for the Secretary to announce higher purchase prices than those specified in the bill.

Secretary Vilsack used that discretionary authority to increase the purchase prices for cheddar cheese and nonfat dry milk in August, September and October 2009. The Secretary increased the purchase price of cheddar cheese by 18 cents per pound (16%) and nonfat dry milk by 10 cents per pound (15%). This action resulted in few dairy support program purchases by the CCC, as product prices increased over the same period.

In November 2009, support prices for cheddar cheese and nonfat dry milk under the DPPSP reverted to the levels specified in the FCEA. The Secretary's authority to make changes in the DPPSP support prices are limited by available funding. The Congressional Budget Office, using budgetary guidelines created by Congress itself, determines if Congress can afford to pass a bill that has budgetary implications. Once a bill becomes law, if it involves some discretionary action or decisions by the Secretary, then the President's Office of Management and Budget has the authority to decide if the Executive Branch can afford it.

The DPPSP does offer the Secretary some flexibility in application and is addressed further as a recommendation later in this report.

Risk Management Programs to stabilize farm gross income

Dairy farmers may use public or private programs to manage risk. Farmers, without government assistance, can hedge milk or input prices using futures and options contracts on traded exchanges. In addition, depending on location, some farmers can forward contract milk with dairy

cooperatives and other buyers. This choice is not available to farmers in California because no permitted forward contracting mechanism exists within the structure of state-regulated milk pricing system there. Farmers can also forward contract some inputs, mainly feed, with suppliers.

There are some concerns that limit the use of risk management tools. Futures contracts may be "lumpy," offered in unit sizes that are not easy for small producers to use on their own. Also, some hedging tools require "margin," a posting of earnest money to cover the financial exposure of hedge positions. These margin calls are designed to make sure that those with positions in the futures market are able to meet their financial obligations under their contracts. Margin requirements can tie up a significant amount of cash in a dairy operation.

Livestock Gross Margin (LGM) Dairy

LGM-Dairy, introduced in 2007, is a bundled hedging tool that provides protection to dairy producers for the difference between feed costs and milk prices. Rather than having to hedge milk prices and feed prices separately, LGM-Dairy establishes a floor on gross margins (milk price minus feed costs) and pays an indemnity if the margin falls below the established floor. The farmer chooses how much of his or her milk to cover and the month of the coverage. Premiums are based on expected milk revenue and expected feed costs that are calculated using futures market prices on Class III milk, corn and soybean meal at the time the insurance is purchased. While any given farmer's milk revenue or feed costs will not equal the futures prices on the Chicago Mercantile Exchange (CME), his or her margin changes are expected to correlate closely enough to CME price movements to make the tool useful for reducing risk.

Unlike futures contracts, LGM-Dairy does not require a minimum amount of milk. Producers may sign up for this program monthly and may choose to cover up to ten months of production at a time. Farmers may not purchase insurance for margins on more than 24 million pounds of milk over that period.

Recently, the Risk Management Agency announced several changes to how they would administer LGM-Dairy. The new LGM-Dairy uses a different procedure for calculating milk returns

over feed costs that may correlate more closely with farmers' actual margins. The new program also encourages producer participation by providing a subsidy to lower the premium costs for farmers.

Adjusted Gross Revenue Lite (AGR Lite)

In 1998, RMA developed a new insurance product intended for all farmers and based on adjusted gross income (AGI) as reported on Schedule F of the farm business's taxes. The program combined protection from production losses related to natural causes with output price declines or input price increases related to market fluctuations. The product became quite complex and was difficult to use. AGR-Lite was developed in 2002 to provide a simpler tool that would have the same goal.

Any farmer can use AGR-Lite and the revenue protection applies to the whole farm, not just one product. Premiums are lower for farmers who sell more products because their expected total margin risk is reduced by that diversity.

Participation rules are not particularly conducive to dairy production. No more than 35% of farm income can come from animals or animal products. Milk marketings are limited to 1.6 million pounds. The program only calculates costs of feed that is purchased, not feed that is grown. Total farm liability cannot exceed $1 million and gross income must be below $2,051,282.

Farmers select the coverage percentage of their total adjusted gross income and the percentage of the difference that they can receive if their actual AGI is less than the income coverage that was determined for them. The maximum income coverage is based on each producer's average AGI over the previous five years.

Livestock Risk Protection (LRP)

The USDA Risk Management Agency's Livestock Risk Protection (LRP) program could be expanded in a way that it would serve as a supplement to the base Milk Income Loss Contract (MILC) program. (LRP is currently only offered for feeder cattle, fed cattle, swine,

and lambs.) The LRP essentially allows livestock producers to set a floor on market prices based on the expected marketing date. The LRP program is similar to buying put options except that it eliminates the "lumpiness" issue that is inherent with futures and options contracts; a producer only buys coverage on the specific number of animals he or she is feeding rather than trying to meet futures contract weight specifications. RMA subsidizes 13% of the premium cost and covers all administration and overhead costs for the program. Unlike LGM-Dairy coverage, which can only be purchased after 5:00 p.m. on the last business Friday of a month, LRP coverage can be purchased on any business day of the month. Also unlike LGM-Dairy which is complex with many different options[26], coverage options and costs are very simple for a producer to calculate using RMA's on-line calculator (http://www3.rma.usda.gov/apps/livestock_reports/main.aspx). If the LRP were to be extended to fluid milk, an element could be added that would approximate call options on a typical dairy feed ration. The net effect would be the ability to protect a milk price: feed cost margin on a per cwt basis. Different levels of protection could be offered at different premium levels. For example, producers would pay a higher premium to protect 65% of their margin than they would to protect 55% of the margin.

Use and Participation in Risk Management Programs by dairy Farmers

Few dairy farmers have participated in these programs. Several factors explain this lack of participation. Size limits, market conditions, and program design and targets all contribute to their low participation by dairy farmers.

[26] There are 650 million different combinations of options available to dairy producers under LGM-Dairy: 68 different levels of corn; 48 different levels of soybean meal; 100 different combinations of months of coverage; 100 different levels of milk production that could be insured; and 20 different levels of deductibles. From a December 1, 2010 presentation in Dodgeville, WI to a small group of staff from the Wisconsin Farm Center by Ken Hartzell, Crop Insurance Specialist with Badgerland Financial.

This subcommittee agrees with the recommendation of sub-committee A that an examination and overhaul of Risk Management Programs in order to make them easier for dairy farmers to use. Current feedback from the farm community is that these programs are much too complicated and involve too much paperwork. The limiting factors described above should also be addressed in order to develop these programs into valid risk management tools for dairymen.

Market News, Research, and Promotion Programs

Numerous programs exist to support dairy market development, day-to-day dairy business decisions, and the ability of dairy businesses to plan. They do so by providing information on milk and dairy product prices, market conditions, and the market outlook. Such programs include the AMS Dairy Market News, various data serials published by NASS, ERS, and FAS, and special analytical reports by ERS and WASDE. USDA also has certain programs for market and business development and AMS participates in the oversight of the National Dairy Promotion and Research Board.

These programs typically provide valuable information for buyers and sellers in dairy markets and are useful in the long term to mitigate risk in planning for the future.

New Product/Innovation

Milk Fortification

Milk Fortification has been a point for discussion within the dairy industry for many years as a way to increase demand and supply disappearance in the short term. There have been numerous studies of the effects of imposing California fluid milk standards across the US[27]. The increased use of nonfat solids reduced Commodity Credit Corporation (CCC) inventories of nonfat dry milk and raised prices for nonfat solids, which tended to increase farmer pay price. The true impact of any policy change depends on the exact implementation of the new policy. Analysis of imposing California fluid milk standards across the rest of the US is dependent on some key variables which

[27] Salathe and Price, Outlaw et. al., Boynton

include how costs of fluid milk fortification will be shared and how consumers will accept a higher solids fluid product.

A new economic analysis by the Food and Agricultural Policy Research Institute (FAPRI) at the University of Missouri was completed at the request of the Congressional Dairy Farm Caucus to consider the potential effects of mandating California fluid milk standards on a national level. The report determined that requiring higher nonfat solids in fluid milk would boost prices to dairy farmers, but said those gains would diminish over time as markets adjust to the higher prices.

The study indicated that fortifying the nation's milk to California standards would remove an additional 350 million pounds of nonfat solids per year. That would drive nonfat dry milk prices higher and increase farm milk prices by 27 cents per hundredweight during the first year. Those price increases would then slip to 17 cents in the second year and narrow to 9 cents by the seventh year, the study said, as farmers increase milk production in response to the higher prices. The study estimated that the retail price of a gallon of milk would rise about 17 cents, as processors pass on to consumers the additional cost of fortification. According to the study, the jump in retail price would lead to a slight drop in milk consumption.

The FAPRI study also showed that price benefits to dairy farmers were regional, with farmers in heavy NFDM-producing states, such as California, benefitting while dairymen in large cheese-producing states, such as Wisconsin and Minnesota, actually seeing milk price decreases over time. The issue of regional inequity, as well as uncertainty around the potential for encouraging imported solids, incomplete data on total cost of fortification used in the FAPRI analysis, the lack of excess NFDM in the U.S., and uncertainty around the amount of plant investment's impact on consumer cost must all be addressed before this subcommittee is able to take a position on this topic.

Comparison of California and U.S. Fluid Milk Standards

Product	California	U.S.
Fat		
Whole	3.50%	3.25%
Reduced Fat	1.9%-2.1%	2.10%
Low Fat	0.9-1.1%	1.20%

Non Fat	0.20%	0.20%
Solids Non Fat		
Whole	8.70%	8.25%
Reduced Fat	10%	8.25%
Low Fat	11%	8.25%
Non Fat	9%	8.25%

Source: Food and Agricultural Policy Research Institute, University of Missouri

Standards – Somatic Cell Count

Ramifications of Adopting Stricter Somatic Cell Count Standards for Grade A Milk

The subcommittee decided to recommend the adoption of a stricter maximum somatic cell count for Grade A milk, in the range of 400,000–450,000 cells/ml at the farm level. (The current level is currently at the 750,000 cells/ml). The EU requested U.S. exports to their country be at European standards 400,000 cells/ml. This proposal would increase access to European markets and encourage producers to remove inferior animals and increase quality of US milk. This may enable the US to be more competitive in other markets as well. However, the move to stricter standards should be done carefully so as to not inhibit our competiveness in the market and provide greater strain to dairy producers and those agencies that support them.

The Milk Producers Federation (MPF) was cautious initially but is moving towards this proposal in a step wise fashion. The most recent resolution by MPF currently sets out a limit of 600,000 per mL effective Jan. 1, 2012; 500,000 per mL by Jan. 1, 2013; and 400,000 per mL by Jan. 1, 2014. It should be noted that the resolution gives some discretion for seasonally dependent events.[28] Currently, developments towards stricter SCC standards in Grade A milk are in flux. As Matt McKnight, United States Dairy Export Vice President states, "Any program specifics at this point are preliminary. Until Europe confirms the minutes from the July meeting, it is too early to speculate on

[28] http://nmpf.org/latest-news/news-dairy-coops/articles/eu-somatic-cell-count-standard-still-unresolved

the elements of a testing program or the potential repercussions of tests that exceed EU SCC ceilings."[29]

The regulatory change for Grade A milk should be put in place carefully by the FDA because the European regulation is quite different than the current policy in the US. If we increase US standards to meet the EU standards, we should use similar testing mechanisms so we do not put unnecessary burdens on US producers and regulatory agencies. The focus on farm level SCC counts is a dramatic change from using the silo or tanker for testing for regulatory purposes. Also, the US method of SCC sampling for purposes of regulation is a one–point-in-time versus the EU's three-month rolling geometric mean. It should also be noted that Europe makes exceptions to this standard for products like raw aged cheese and certain countries like Romania are exempt. The feasibility of separating milk which is above 400,000 but below 750,000 should be explored so that it could still be marketed in the US. If this is not feasible some producers may be forced to leave dairy. The possible benefits from trade need to be balanced with increased costs on state food safety divisions which are currently understaffed and underfunded. The US dairy industry should be able to adapt if the regulations are put in carefully. We have seen the industry adapt previously in response to higher standards when the standards were reduced from 1,500,000 to 1,000,000 in the 1970s and from 1,000,000 to 750,000 around 1990.

Organic and Value Added production methods

The organic dairy industry has grown to approximately four percent of the total dairy industry with approximately 2,065 farm operations and approximately 220,000 organically certified cows.[30] The commercial organic milk market began in the mid-1980s, but did not gain national market share until after the year 2000 when Horizon Organic and Organic Valley established national distribution and procurement networks. From 2002-2007, the organic milk market saw incredible growth, which brought ample opportunity for producers to maximize their return from organic production and for

[29] http://www.usdec.org/files/PDFs/Export_Profile_Sept_2010.pdf

[30] USDA 2008 Organic survey and census

processors to establish an infrastructure for future profitability while meeting their costs and profitability goals. During 2007 and 2008, supply increased at a faster rate than demand and there was at times a surplus of supply which spurred an increase in manufactured dairy product. In 2009, the sharp increase in market demand slowed, dropping from an annual increase of 20-25%, to 3-5% for fluid milk sales and a drop in sales of manufactured dairy product (cheese, yoghurt, ice cream). With no plans in place for supply management, a rapid surplus developed with only very limited warehouse capacity to store organic cheese, butter and powder, which are traditionally used as one method for handling surplus. In 2010, the demand for organic milk rebounded and is currently running at a projected 9% growth for 2010.[31]

Many non-organic dairy farmers have found operating in the organic milk market beneficial to their farm business. The organic milk market is less volatile than the non-organic market because farmers lock in a higher base pay price under a one to two year contract, or an annually determined price by a cooperative board. Whereas the non-organic base pay price fluctuates with the world market, the organic pay price has historically remained the same over the course of the year. This has helped producers plan financially and focus on managing the factors they can control to help their bottom line. The organic market also has added benefits such as low or no hauling fees, field staff to help with the transition, and access to a dedicated group of extension personnel.

While the organic production methods and market may not suit some dairy farm operators, it is a national alternative that is available to those that see the potential within their location and farming goals. This is particularly true for small to mid-size dairies, a group that is disappearing from the non-organic market at an increasing pace.

In addition to organic, there are other value-added opportunities for the production and sale of milk commercially which include raw milk, grass fed, natural and local that return income directly to the farm operator.

With the introduction of new policies and programs it is important that they do not hinder the growth of these value-added opportunities for those farmers that wish to innovate and change to meet

[31] USDA AMS Organic Dairy Report

consumer demand. While the markets are limited, the opportunity for individual farm families to become profitable is not.

Grant based incentives

Grant based incentives could be directed specifically at 'at risk' small operations that don't have cash or access to credit to make changes in order to:

i. Lower inputs (energy, fuel),
ii. Change production practices to enable long term lower cost production
iii. Initiate value-added programs
iv. Transfer operations to the next generation
v. Open space and farm preservation from development

EQIP

The Environmental Quality Incentives Program (EQIP) was approved in 1996 by amending the Food Security Act of 1985 (Farm Bill), reauthorized in the Farm Security and Rural Investment Act of 2002 and again reauthorized in the Food, Conservation and Energy Act of 2008. EQIP provides a voluntary conservation program for farmers, ranchers and owners of private, non-industrial forest land that promotes agricultural production, forest management and environmental quality as compatible national goals. EQIP offers financial and technical help to assist eligible producers install or implement conservation practices on eligible agricultural land.

The five EQIP national priorities are:

1. Reductions of nonpoint source pollution, such as nutrients, sediment, pesticides, or excess salinity in impaired watersheds consistent with Total Daily Maximum Loads (TMDLs), where available; the reduction of surface and groundwater contamination; and reduction of contamination from agricultural point sources, such as concentrated animal feeding operations (CAFOs);
2. Conservation of ground and surface water resources

3. Reduction of emissions, such as particulate matter, nitrogen oxides (NOX), volatile organic compounds, and ozone precursors and depleters that contribute to air quality impairment violations of National Ambient Air Quality Standards

4. Reduction in soil erosion and sedimentation from unacceptable levels on agricultural land and

5. Promotion of at-risk species habitat conservation.

EQIP offers contracts with a minimum term that ends one year after the implementation of the last scheduled practice(s) and a maximum term of ten years. These contracts provide financial assistance to help develop conservation plans and implement conservation practices. Owners of land in agricultural production or persons who are engaged in livestock or agricultural production on eligible land may participate in the EQIP program. Program practices and activities are carried out according to an EQIP plan of operations developed in conjunction with the producer that identifies the appropriate conservation practice or measures needed to address identified natural resource concerns. The practices are subject to NRCS technical standards adapted for local conditions.

EQIP may provide payments up to 75 percent of the estimated incurred costs and income foregone of certain conservation practices and conservation activity plans (CAP).

Historically underserved producers (limited resource farmers/ranchers, beginning farmers/ranchers, socially disadvantaged producers, Native Americans) may be eligible for payments up to 90 percent of the estimated incurred costs and income foregone.

Recommendations

Tight budgetary constraints will complicate matters considerably. Congressional pay-go rules, a smaller CBO baseline, budget reconciliation, and a looming Federal budget deficit will mean that the 2012 Farm Bill will be written under much tighter fiscal obligations than recent omnibus Farm Bills.

MILC or an MILC type program:

This subcommittee supports the MILC because of the reasons stated earlier. We would support the MILC program to at least the 45% differential and the 2.985 million-pound cap beyond September, 2012[32] because of the reasons stated earlier in the report.

The Farm Profitability sub-committee recommends that in the 2012 Farm Bill, the MILC program or a program similar to MILC be enacted and suggests the following changes to the current program:

1. MILC current trigger replaced with an all milk income/feed costs margin trigger rather than the existing criteria.
2. Caps would be determined by available funds and other criteria based on maintaining family farms most threatened by non-market inflated inputs. This sub-committee also discussed the option of insurance for producers excluded by a cap.
3. Increased counter-cyclical payment for environmental practices that address the social, economic and environmental benefits of dairy farm to some communities.

Stricter Somatic Cell Count Standards for Grade A Milk

The subcommittee decided to recommend the adoption of a stricter maximum somatic cell count for Grade A milk, in the range of 400,000–450,000 cells/ml at the farm level. (The current level is at the 750,000 cells/ml).

Farm Savings Accounts

The subcommittee recommends that Farms Saving Accounts be made available to dairy operators with the following conditions:

A. No government match.
B. No limits on the dollars deferred per year.
C. Require money to remain in account a minimum of six months and allow withdrawal at account-holder's discretion thereafter.
D. Tax deposits and interest upon withdrawal from the account.

[32] In September, 2012 the feed cost used to calculate the differential is set to increase and the cap is set to decrease.

Export Market Development

The profitability subcommittee recognizes the importance of international market development to the future of the US. dairy industry.

The subcommittee recommends that USDA maintain and expand USDA programs like the Market Access Program (MAP) and the Foreign Market Development (FMD) programs administered by the Foreign Agriculture Service (FAS) that fund activities that introduce US-produced dairy products to key export markets and are important components of the budgets of organizations like US Dairy Export Council.

Develop Industry Margin Measurement

The profitability subcommittee recommends that USDA implement a data gathering and reporting system that uses a milk price-feed cost margin calculation as a methodology as an index for farm profitability. While this index would not be representative of the profitability on individual dairy farms, it would serve as a better reflection of farm-level economic health than current milk-price-only measurements do. This would tie in with using the milk price feed cost margin calculation within the MILC and allow greater transparency and confidence in the process for farmers.

Federal Milk Marketing Orders (FMMO)

Although FMMOs provide many valuable services to the dairy sector, there is some question around the role of end-product pricing and pooling on exacerbating milk price volatility and discouraging dairy product innovation.

Adopt Competitive Pay Price and Move Away from Using CME Spot Markets and End Product Pricing.

This subcommittee recommends a shift to a competitive pay price system based on Class III milk, and away from the complicated end-product pricing system. This would simplify the dairy pricing policy regime and would abandon the focus on a thinly traded CME spot market for pricing.

This would also lessen the current focus on the federal milk marketing orders and allow producers and other market participants to respond and innovate in response to market signals.

The most competitive markets for fluid milk could be studied (e.g. Minnesota-Wisconsin was used before competitive pay price policy was abandoned 10 years ago). The base price of milk would be set in these aggressively competitive markets. Competitively established prices could be used to set Class III base prices in less competitive parts of the country. Over 40 percent of US milk is used for cheese production so the competitiveness of the market should keep producer prices stable. In this way, regional differentials would be eliminated. It would exempt handlers in competitive markets from minimum price requirements to allow free competition to set milk prices. One note of caution on using a competitive pay price in one region for other regions of the country is that communicating the competitive pay price could cause delays and market distortion[33]. This issue could be remedied with further study and exploration.

Collapse the current four class system to two classes

This subcommittee would support collapsing the current four-class system to two classes so as to help milk flow to its highest-valued use which would make pricing and reporting simpler at the processor level.

We would retain the pooling and price reporting features of the current marketing order system and still rely on the Producer Price Differential (PPD) which helps to smooth out value differences between manufacturing and beverage milk. This should reduce volatility. Another way to decrease volatility is that prices could be averaged to a mean of 12 months (or some other length of time), which would lessen volatility and increase ability to plan. More recent months could be weighted more heavily.

[33] Stephenson, M. 2010 (June 15). Milk Price Discovery - Alternatives to the Current Product Price Formulas. University of Wisconsin-Extension [WWW] http://www.extension.org/pages/Milk_Price_Discovery_-Alternatives_to_the_Current_Product_Price_Formulas

Risk Management Programs

This subcommittee recommends an examination and overhaul of both LGM-Dairy and AGR-Lite in order to make them more accessible and easier for dairy farmers to use. We also recommend that the Agency's Livestock Risk Protection be adapted to enable it to be used by dairy farmers. Farmers have expressed that these programs are much too complicated and involve too much paperwork. The issues driving lack of participation should be addressed in order to develop these programs into valid risk management tools for dairymen.

In addition, these programs would greatly benefit dairy farmers if they could, in addition to providing risk management mechanisms, provide comprehensive education on risk management. Because volatility in the dairy industry is a relatively new experience (less than 20 years) for many farmers, it is understandable that farmers are unsure of whether or how to manage their own risk. USDA risk management programs could provide a valuable tool to dairy farmers simply by providing that education, regardless of the actual risk management tools used.

Reducing barriers to the growth of on-farm value-add and specialty enterprises with appropriate new regulations

This subcommittee recommends that:

- Any changes to, or introduction of, new regulations be size appropriate.
- In the design and implementation of Food Safety regulation there should be recognition of actual threats and risk from different size operations.
- Funds should be provided for appropriate training for State and Federal inspectors and regulators for small to medium sized value-added farm operations.
- Fee structures should be set by agencies for equity and fairness.

This subcommittee acknowledges that in some circumstances, regulation can inhibit the growth of on farm value-added enterprise and provide high barriers to innovation and profitability for dairy farms that want to maximize their location or product by selling direct to the consumers. Adding

disproportionate expenses to farms and food producers that already depend on slim margins will reduce opportunity and create barriers to entry for producers of all scales. Overextended regulations will undermine private and voluntary systems of training and continuous improvement, and will undermine any sense of "shared responsibility" among all food-system players, ultimately harming the public the regulations purport to protect. Establishment and enforcement of baseline standards, especially in areas of greatest known risk, is an important responsibility of government. Federal, state and local agencies need to work together in a consistent fashion to tailor enforcement that is appropriate and effective in light of local and regional realities, reinforcing a multi-stakeholder process of continuous improvement.

Grants for green programs and economic rural development

This subcommittee recommends that the impact of dairy farms as job creators, the multiplier effect on the economy and reduction of the tax burden on local economies should be addressed by Federal and State support for dairy farms with funds not traditionally targeted for dairy operations. While the economics of the dairy industry in 2011 make consolidation of milk production preferable, the Secretary has reminded this committee that the USDA must be aware of the needs of all farmers, not just those in large scale production agriculture. The different policy and program areas that would benefit farm profitability and also address the social, economic and environmental challenges to farm profitability and provide a nationwide supply of milk include the following:

Funding the EQIP program that will provide cost share monies for many production and manure handling systems that will improve farmer productivity and profitability. Those dairy farmers of a certain size in areas where their continued profitability affect the rural economy should be classified as 'limited resource farmers.'

Preference to dairy farms of a certain size in grant programs that include:

1. Implementation of recommendations from Energy audits

2. Infrastructure that benefits value-added dairy processing, warehousing and distribution for individual dairy farms or groups of dairy farms

3. Construction of facility improvement to meet new Food Safety and existing Federal and State regulations

4. Programs that pay farmers the difference between the agricultural value and the commercial value of land in order to preserve and protect agricultural land, including designated farmland soils from being built upon for non-agricultural purposes or used for any activity detrimental to agriculture and to maintain land values at a level that can be supported by the land's agricultural uses and potential.

Dairy farm families that are transferring their operation to the next generation be eligible for grant funds under the classification of 'beginning farmers.'

FSA should follow best practices developed in states like WI to assist farmers with flexibility of payments and extended terms that they offer can often which can assist an otherwise profitable small dairy farm form being placed in foreclosure.

Areas for further Discussion

Milk Fortification

This sub-committee recommends that this discussed be continued on this topic as the subcommittee is divided and needs more information on the cost of the program (both to consumers and processors) cost of testing, validity of demand projections, impact in different regions and a cost-benefit analysis of the short term gain in farm profitability and milk disappearance.

Further overhaul of the FMMO

Although FMMOs provide many valuable services to the dairy sector, there is some question around the role of end-product pricing and pooling on exacerbating milk price volatility and

discouraging dairy product innovation. This topic may or may not come under the purview of the whole committee.

Growth Management as it applies to Farm Profitability

Concentration in Markets and Supply Chain and how they affect farm profitability