Hot Issues that Affect Milk Production (Inter) Nationally

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We are pleased to be a part of your conference. We look forward to sharing our perspectives on a number of issues that we consider timely and important to the U.S. dairy industry and also how our industry relates to the rest of the world.

Among the issues discussed will be:

- The ethanol industry and its many ramifications within our industry and beyond
- Federal order issues
- 2007 Farm Bill issues
- Immigration policies and impacts
- Shifting patterns of U.S. milk production
- Consolidation in the U.S. livestock industry
- Observations on milk-per-cow trends
- Dairy cattle research needs and priorities
- Future threats to how we operate

Copies of the presentation will be available at the conference.

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There's a Chinese curse: "may you live in interesting times." Well, these indeed are interesting times in the dairy industry. There are a number of factors, forces, and issues at work in our industry now. Many of them are hitting us in the pocketbook now, and many will affect how and where milk is produced in the future.

The title and topic assigned to me provides enough leeway to pretty much give me an open field. I plan to cover a lot of ground, without plowing too deep in any one area. I'll be throwing out a lot of numbers, and I apologize for that. For those of you interested in the details, we'll make sure you get a copy of my presentation.

It's good to be out traveling when the future looks a little brighter. As many of you know, Class III futures between May and December have been averaging well over $17 per hundredweight. We could end up with the highest milk prices in history by the end of the year. I'll leave the forecasting to Mary Ledman. I'm looking forward to what she has to say.

But the price relief we're getting can't come soon enough. And for some, it's coming too late. People across the country have been telling us 2006 was the toughest year financially in memory. It was the double whammy of low prices and higher costs.

We looked at it this way. The average Class III price last year, the benchmark that drives mailbox prices for you folks as well as those of us up north, was $11.89. The last time the annual average Class III price was in that range was 1995, when it was $11.98. However, during the past 11 years, feed has gone up 23 percent (it's a lot higher than that now); seed, 65 percent; fertilizer, 49 percent; ag chemicals, 11 percent; fuel, 172 percent; supplies/repairs, 29 percent; farm machinery, 56 percent; building materials, 33 percent; interest, 34 percent; taxes, 46 percent; wage rates, 51 percent; and family living, 33 percent.

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In addition to this severe cost/price squeeze, we know many of you have experienced some pretty devastating hurricane and tornado damage. We don't need to remind you about the decline in dairy operations throughout the Southeast. But, in some respects, we're surprised it hasn't been even more drastic.

I know there are attempts to fix what we might call the Southeast problem. You can only do so much about the heat and humidity, so you see the need to work on the marketing side. I know you are taking a serious look at how federal orders can be changed to your benefit.

I did learn more about milk marketing in the Southeast when I read an article by Bill Herndon at the University of Mississippi which is the Milk Check Outlook column in our May 10 issue being mailed soon.

Bill documents the rising population and declining milk production in this region. He wrote that 72 percent of milk processed in Southeast plants during the year 2000 was produced within the region. By last year, that had dropped to 55 percent.

Each day of the year, 6 million pounds of milk (120 trailer loads) must be imported from other states just to fill the raw milk requirement of your processors. One co-op operating in this area estimated it cost between $5 and $7.50 per hundredweight last year to move milk from Clovis, New Mexico, to major cities in the Southeast. And you folks know better than anybody who is paying the freight. Bill Herndon's article puts the cost to the Southeast dairy industry at around $30 million a year.

People outside of this region who read that article will have a better understanding of the supply/demand dilemma you folks have been facing for years.

The reasons for giving federal orders every benefit of the doubt vary from region to region. Obviously, you folks have issues you feel you need to work on.

But we would like to remind our readers that, among other things, producers vote on how federal orders determine the minimum prices that are to be paid by processors, including those for fluid milk, and those prices provide the framework for over-order premiums. This is one of the most compelling reasons for retaining federal orders.

Class I differentials added $107 million to Florida order milk checks last year and $142 million to Southeast order checks. With your high Class I utilization, you may feel you can maintain those prices without a federal order. Whether or not that is possible is a very crucial point. Across all federal orders, Class I differentials added almost $1.2 billion to milk checks last year or nearly $19,000 per farm.

Interestingly, there is a misconception that fluid milk contributes little to checks in the Upper Midwest.

If fact, some people back home believe that action that improves Class I prices — anywhere — is bad. We wonder why. Upper Midwest Class I milk is big business. That order accounts for about 10 percent of all federal order Class I milk. Class I differentials added $78.5 million to Order 30 milk checks last year. On top of that, over-order fluid premiums have added an average of another $97 million to order milk checks during each of the past three years.

The thinking in that region is that any action that raises Class I revenues across the country creates overproduction elsewhere and stimulates production of cheese and butter, lowering manufacturing milk prices here in the Upper Midwest. But, clearly, it is NOT the high Class I use areas that are expanding milk production. It is the areas with lowest Class I use . . . Idaho, the Southwest, and California.

Now let's shift gears a little. Ethanol, ethanol, ethanol. Is it possible to pick up a magazine or newspaper without reading something about ethanol, renewable energy, or energy dependency? And, of course, there's all the distillers grains that will be available and how well people can make use of them in dairy rations. I'm looking forward to what Charlie Staples has to say. (What this country really needs are recipes that make chicken breasts palatable and rations that make distillers grains usable.) Of course, there are questions about how good a buy distillers will become. Last week, a Wisconsin ethanol plant manager told me that it costs little to ship distillers to Asia. It goes as a backhaul with the containers we import our gadgets and gizmos in.

There's plenty of concern about the impact of high corn prices and related feed costs on the livestock industry. And with good reason. Feed costs make up the greatest proportion of cash expenses for all of animal agriculture, and we expect to see higher feed grain prices for another four to five years. We noted the article in the Sarasota paper that quoted Albert de Vries and Maggie Murphy from Southeast Milk. That was well done.

On the other hand, we get irked when we read and hear about how the nearly manic interest in ethanol will usher in a new heyday for U.S. agriculture and transform rural America. Land prices are shooting up, rents are skyrocketing, and have you been watching John Deere's stock?

But wait a minute. Just what role does corn itself play in the agricultural community?

Corn ranked first in share of farm receipts in just two states in 2005 . . . Illinois and Indiana. In 13 others, soybeans, wheat, greenhouses (that would include Florida), sugar cane, or apples ranked first. In all other states, dairy, cattle in general, hogs or broilers ranked first. (The exception was Kentucky where horses ranked first.)

Dairy income was first in nine states; it ranks seventh here in Florida. Other cattle ranked first in 13 states. Broilers led in nine states, hogs in two. Nationally, cattle ranked first contributing more than $50 billion out of $240 billion in farm cash receipts.

Corn prices are going to be a blow to the agricultural economies in many states. We will see wholesale (and retail) prices of livestock products go up. However, before that happens in any significant, lasting way, there's going to be a lot of pain felt by dairy farm families and other livestock producers.

Along that line, already we're tired of hearing and reading about higher food prices. We would have a couple of brief messages for consumers and the fear-mongering media that fuel their anxieties.

First, U.S. consumers spend less than 10 percent of their disposable income on food. That's the lowest in the world.

Second, wholesale food prices are going up, but there are many other factors that have more bearing on what grocery store scanners reveal. Here's why.

Considering an entire market basket of food products, the farmer's share has averaged 21.6 cents out of each $1 over the past three years. The difference — 78.4 cents out of each $1 spent — goes to assembling, processing, transporting, distributing, and retailing, and the profits associated with those activities.

Let's look at the 2006 marketing year farm share of a retail dollar: meat products, 31.6 cents; dairy products, 27.1 cents; poultry, 37.7 cents (think consolidation and vertical integration); eggs, 29.7 percent; cereal and bakery, 6.3 cents; fresh fruits and vegetables, about 18 cents.

Now, to be fair, we realize that businesses further down the supply chain have to deal with escalating costs . . . wages, employee benefits, diesel fuel, interest rates, rents, and so on. Of course, these are exactly the same higher expenses that those of us who produce milk and other food are facing also.

We expect to see a greater decline in dairy farm numbers due to feed prices. Our aging population of dairy farmers will have to choose between continuing to milk on one hand and the possibility of selling $4 corn or getting a cash rent of $200 per acre on the other.

It will be interesting to see whether, and if, the high feed grain costs affect where milk will be produced in the future. We've already talked about what has gone on here in the Southeast. And, of course, we all know how milk production has shifted West. During the past five years, milk production in the western states has gone up 21 percent, compared to 9.8 percent for the U.S. The West has added 430,000 cows, while the nation's cow herd has remained the same size.

But things are slowing down in California and Idaho. Both states have some real environmental issues. Californians are really seeing their feed and energy costs shoot up. The people in Idaho, without their federal order which was voted out in April 2004, are being taken advantage of by the cheese companies. Some months they are getting paid as little as $2 below the Class III price. Now the big growth area is west Texas and New Mexico . . . not necessarily good news for us in the Midwest. That puts cheese made in the Southwest that much closer to the East Coast markets we like to serve.

I mentioned consolidation and vertical integration. Our May 10 issue will include a 10-year perspective on changes in the livestock industry. It's probably no surprise that other livestock industries are more concentrated than dairying, with a couple of interesting exceptions.

One complication in making comparisons is the incredible number of small, part-time owners of beef cows and layers, especially. For example, 84 percent of farms that have layers have 100 birds or fewer. More than three-fourths of those with beef cows have fewer than 100 head.

Looking at the past 10 years, the decline in hog operations has been greatest (-60 percent). That was followed by operations with dairy cows (-43 percent) and beef cows (-5 percent of those with 50 head or more). There actually were more broiler operations in 2002 than there were in 1992 and more commercial feedlots in 2005 than in 1996.

One measure of concentration is the number of operations that contain half of all the animals or birds. Here is what we found:

● Just less than half (48 percent) of the nation's dairy cows can be found in 3,143 herds. That is 4.2 percent of all dairy operations.

● By contrast, 51 percent of cattle on feed are in just 125 feedlots. But that's almost 6 percent of the total number of lots.

● The hog business is really concentrated. Only 115 operations (0.2 percent of total operations) have 54 percent of all hogs and pigs.

● The egg business also is quite concentrated. Fewer than 500 operations (0.5 percent of the total) have more than 75 percent of the birds.

Our industry is changing rapidly. But, the degree of consolidation among other types of livestock is much greater. Without cooperatives to bargain for dairy farmers and without federal orders to spread milk revenue over all producers, our industry could look much different. Fortunately, dairying still has a long way to go before it will resemble the poultry and swine industries.

As you can see from the proceedings, I threatened to say something about the 2007 Farm Bill. Everyone in Congress says they want to have a bill before the President by the end of September. That's probably wishful thinking. Plus, based on some of what we have been hearing out of Washington, it is not a done deal that there will be a new farm bill. We still could see an extension of the 2002 bill.

We believe it is safe to say that budget limitations, environmental concerns, and energy policy all will play major roles in the farm-bill debate. With the Doha Round of WTO negotiations pretty much at a standstill, trade won't be as much a part of the debate as in the past. There will be less pressure to move farm policy toward "market orientation" following the change in Congressional leadership last fall.

This go-round, there are a lot more people around the table. For example, the nation's fruit and vegetable growers have become much more organized and more vocal. They feel like they have been left out of past farm bills, and they have to a great extent, and their voice will be heard. The most populous states, those with the most Representatives, are major producers of fruits and vegetables. Of course, conservationists, animal welfare groups, and environmental groups want to be involved. The Environmental Defense Fund has hired an additional 30 staff members to work on farm bill issues.

Not unexpectedly, there has been and will be concerns about the cost and beneficiaries of farm program payments. We can expect some graphic misrepresentations. USDA deserves some blame for the antiquated way the agency portrays today's farms and farm families.

Tim Wise of Tufts University hammers home the USDA problem in a pithy working paper about common errors in presenting farm statistics.

First there's the statement "Only a minority of farmers get payments." The problem is that USDA says there are 2.1 million farms. In truth, only a third of them are farming as a business. The others are "rural residence farms" with little or no cash farm receipts. The reality is that more than 80 percent of commercial-sized family farms receive government payments. Nearly 85 percent of the nation's dairy farmers received MILC payments on their entire milk sales.

Something else you'll hear is that "Farmers are better off financially than the general population." When USDA reports that farm households have annual incomes 118 percent of the average home, we see how misleading averages can be. Well over half of full-time farmers have sales of less than $100,000 a year and have average incomes only 86 percent of the U.S. average, including their off-farm income. The averages for farm household income includes the rural residence farms with household incomes approaching $100,000 but negative farm income. Among typical family farm operations, 30 percent of income is nonfarm. Yet, it is counted as farm household income by USDA.

"Big farms get bigger payments." With most programs linked to production, it is not surprising that larger farms get bigger checks. But, in 2003, the largest family farms (sales of $500,000 or more) produced 44 percent of total farm output but received just 32 percent of main commodity-program payments.

"Farm programs make some farmers filthy rich." There was not one individual farm among the top 20 recipients in 2003. There were 11 corporations, five Indian tribes, two cooperatives, one trust, and one nonprofit, Ducks Unlimited.

I mentioned the Doha Round trade talks, but I would be remiss if I didn't comment on dairy imports and exports. There is a world shortage of milk protein and we are exporting a lot of product . . . and it's adding to our milk checks and will for some time. On a milk solids basis, we're exporting much more than we're importing. However, because of specialty cheeses and other higher-value products being brought in, imports exceed exports on a dollar basis.

We need to be prepared to take advantage of international markets, but we wouldn't want to bet the farm on them. There always are going to be lower cost milk producers . . . now the attention is turning from Australia and New Zealand to Argentina, Brazil, and Eastern Europe. The world's middle class is growing rapidly and, with it, demand for meat and milk products. The question is whether that demand and the money to pay for it will grow faster than world milk and meat production.

Along this line, the demand for milk protein, consider recent nonfat dry milk prices, is raising concern about a structure surplus of milkfat. CWT-assisted exports have given us a foot in the door at many new markets . . . largely with higher fat products . . . cheese, butter, and anhydrous milkfat. In that small way, CWT may help take milkfat off the market, as well as bolster milk prices through reducing cow numbers.

Now let's look at some threats and challenges to our industry. The attention being paid to the demand for BST-free milk troubles us. Here's why:

- All the clamor about BST-free (and organic) milk has caused consumers to question healthfulness and safety of the general milk supply.
- The issue gives zealots — with a variety of motives — another wedge to drive between consumers and dairy products.
- With no milk test to confirm whether BST has or has not been used, there is temptation to cheat. Maintaining consumer trust in our word and our products is absolutely essential.
- It looks like another way processors and retailers can jack up the price without passing more margin back to dairy farmers.
- We wonder how much BST-free demand is being driven by consumers and how much by processors and retailers trying to differentiate themselves in the marketplace. Marketers who label their milk as BST-free absolutely should be using FDA's "no-difference" disclaimer.
- Selling BST-free milk mars FDA's credibility, negates the wealth of BST-related research, and undermines all scientific investigation.

These concerns should bother everyone in our industry. But the sad reality is that there is not a lot any of us can do about this continually nagging issue. Monsanto could quit marketing BST, but we don't anticipate that.

In a perfect world, one could just wave a magic wand, and people would understand that there is no human health risk with milk from cows given supplemental BST. But you can't instill understanding overnight, and you can't alter consumer perceptions through confrontation.

Some have been critical of certain co-ops and other processors for knuckling under to the demands for BST-free milk supplies. That's easy to say from a distance. It's another matter when a major customer is sitting across the desk and there are competitors in the waiting room.

Some have said BST's supplier and others in the biotech community haven't done enough to educate the public. Consumer education is important, but this issue is not going to get resolved by a debate at the dairy case. Our best long-term hope to preserve and increase milk consumption is to stay the course by getting young people to drink more milk.

Providing that the incentives and motivations are adequate and lasting, some consumers will buy BST-free milk, milk handlers will assemble it, and dairy farmers will provide it. If not, the niche market for so-called BST-free milk will go away . . . again. Processors have asked a premium for BST-free milk in the past and quit.

One earmark of the dairy industry is that, we, for the most part, sooner or later give consumers what they want. Reduced fat milk comes to mind. We must never lose sight of the fact that customers, be they concerned consumers or marketers looking for a niche, are always right . . . regardless of what they ask for.

We're in a similar situation with organic milk. Based on grocery store scanner data (not including Wal-Mart), organic milk volume has been climbing at more than 20 percent per year. Still, organic's share of the fluid milk market remains just a little over 2 percent.

Top cities for organic milk sales last year were San Francisco (7 percent of milk volume), Denver (6.5 percent), Seattle/Tacoma (6.4 percent), and New York City (6.0 percent). However, two of the top markets, Denver and San Francisco, had been experiencing drops in organic milk volumes compared to year-earlier levels.

Two executives in the organic milk business have been quoted recently as saying that there is a surplus of organic. One told the New York Times there is a "serious oversupply". We have been concerned about how long organic processors will be able to pay the kind of premiums they have.

Shifting gears again, we're concerned about federal support for disease control and production research. Let's use Johne's as an example.

Federal Johne's funding for fiscal years 2004 and 2005 was $18 million. For the past fiscal year, funding had been cut to $13.3 million. Funding for the current fiscal year has not been been pinned down, but the outlook was not good. The Senate version of the ag approps bill included $10 million for Johne's. The amount in the House bill was $7.7 million.

Our industry lost Jesse Goff from National Animal Disease Center to industry. Many of you will know of Jesse for his important work on milk fever. Jesse could have stayed at USDA, but he knew he never would have been funded well enough to do significant work. The money was going to research related to bio-terrorism and studying TB in bisons at Yellowstone Park.

Unless Congress and the USDA and NIH are approached about something involving national security, bio-defense, conservation or energy, it's pretty much dead on arrival. At the same time, we're struggling with bovine TB, BVD, Johne's, and a variety of other diseases and disorders that are taking money out of our pockets every day of the year.

We commend you for your research check-off and for what those dollars have enabled your investigators to accomplish. It is an idea that should spread to many more states.

Our strategies may have to change in other areas too. We have just learned that 10 Midwestern universities have formed a dairy coalition. They will be cooperating on undergraduate and graduate programs, coordinated use of state dairy extension specialists, and research funding and priorities. We understand such a concept was considered for the Southeast some years ago. Perhaps, it is time to take another look at the idea.

At the end of the day, you have to ask whether you want to view the glass as half empty or half full. We've got our challenges. You have your gestation crate ban and, now, so does Arizona. In 2005, the U.S. Humane Society Fund for Animals took in $120 million, PETA took in $26 million, the Physicians Committee on Responsible Medicine took in $7 million. These folks want to shut us down.

But let's don't sell the farm. Fluid milk consumption per capita actually went up for the first time in decades. Cheese consumption continues to climb although more slowly. One opinion poll shows that the public's confidence in the food supply has not changed one iota during the past six years. This, despite mad cow, bad spinach, BST-free and organic milk, *E. coli* outbreaks . . . you name it.

But that does not mean that we should not remain diligent.

The May issue of *Scientific American* cites U.S. agricultural productivity as one of the least appreciated but most remarkable developments of the past 60 years. Sounds good! But the article ends by saying:

"Modern agriculture is not without a dark side. Runoff of fertilizers, antibiotics, and hormones degrade the environment and can upset the local ecology. If not grown properly, genetically modified crops could spread their DNA to conventional species. And the industrial approach to food has contributed to America's obesity epidemic as well as to sporadic but widespread *E. coli* outbreaks."

Thus are the mixed messages consumers get about us.

Those of us in the dairy industry and agriculture, in general, have done a great job. But we still have a lot of work ahead of us.

Notes