Statement of Dr. Scott Brown

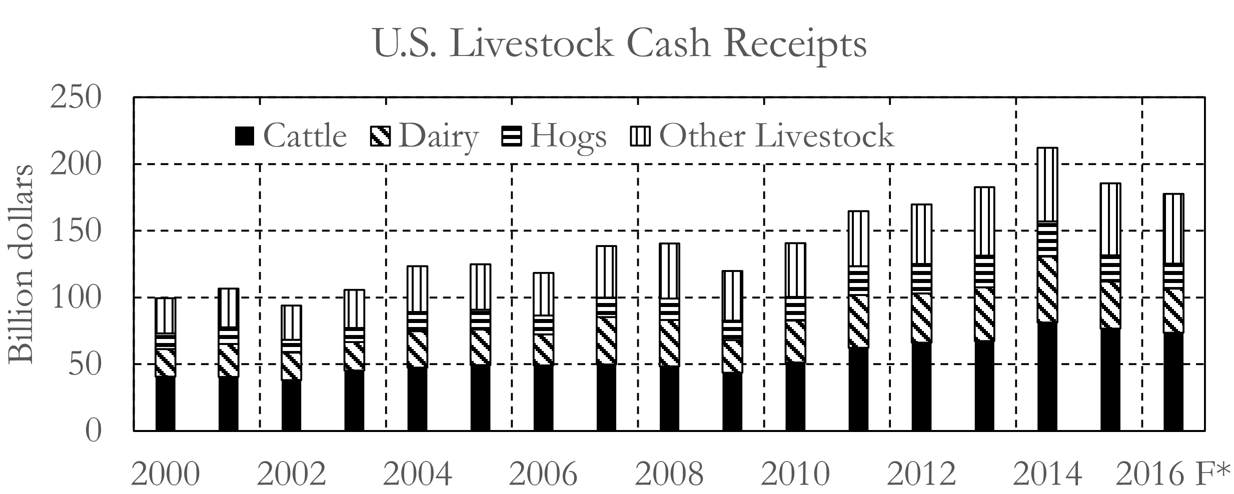
Before the U.S. House of Representatives Committee on Agriculture, Subcommittee on Livestock and Foreign Agriculture

Focus on the Farm Economy: A View from the Barnyard

May 24, 2016

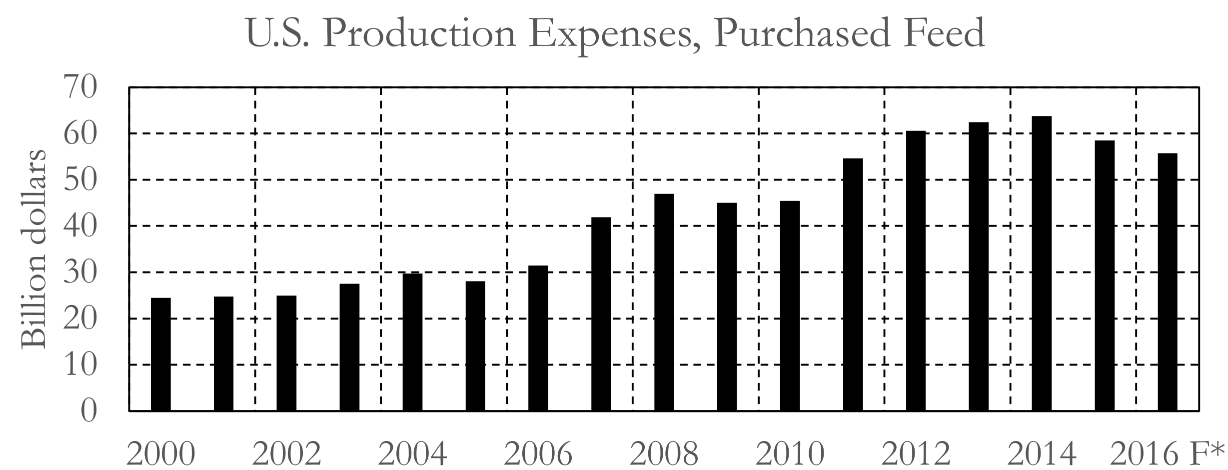
Chairman Rouzer, Ranking Member Costa and Members of the Subcommittee, thank you for the opportunity to testify regarding the current financial situation for livestock producers in this country. I am an agricultural extension economist at the University of Missouri and for the last three decades have worked extensively on livestock policy issues with a specific focus on dairy policy issues.

The previous decade has resulted in some of the best and worst economic times the livestock sector has ever faced. In 2006, USDA reports that livestock cash receipts totaled $118 billion. By 2014, livestock cash receipts had soared to over $212 billion. USDA currently estimates that livestock cash receipts will decline to below $178 billion in 2016.



Source: USDA-Economic Research Service
* - 2016 USDA-ERS forecast

Feed costs, the major input for all livestock industries, skyrocketed over the last decade as weather and other factors drove tight feed supplies. In 2006, USDA reported purchased feed expenses at $31 billion. They rose to $64 billion by 2014. With larger crop supplies, purchased feed costs are currently estimated by USDA to total $56 billion in 2016.



Source: USDA-Economic Research Service
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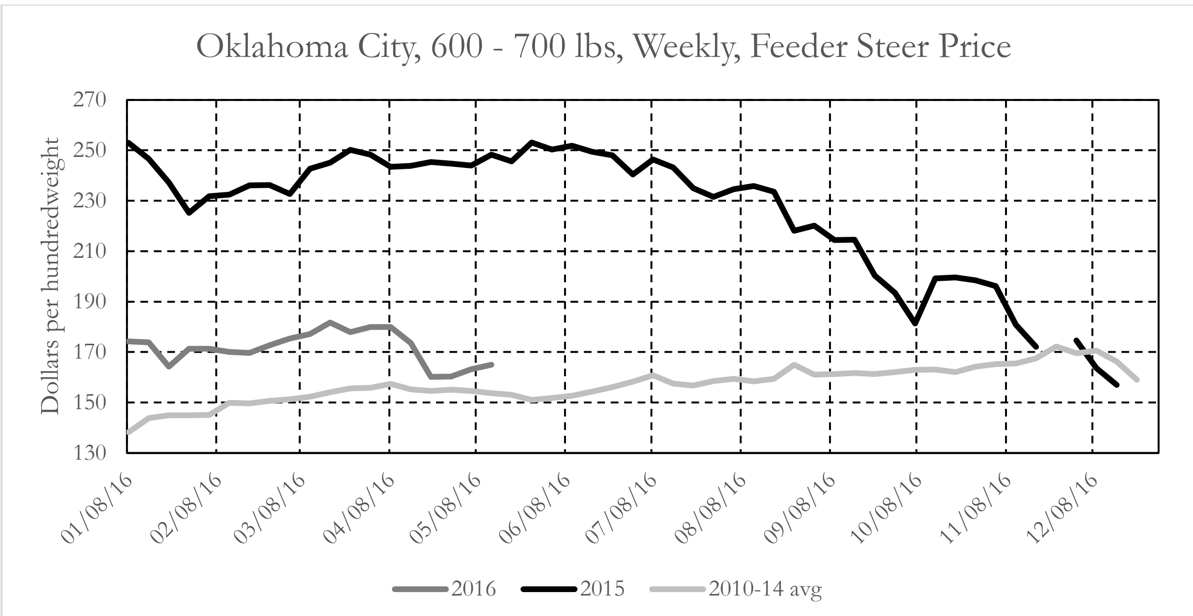
The combination of high feed costs, weather and disease issues placed U.S. meat availability at a 23-year low in 2014. U.S. per capita beef, pork and poultry consumption peaked at nearly 220 pounds per person in 2007 before falling to slightly less than 200 pounds in 2014. 2016 meat per capita consumption will show that at least one-half of the 20-pound decline has been recovered in just two years. This additional quantity of meat in the U.S. marketplace relative to 2014 has driven down prices for livestock products.

One thing is clear when looking at the financial picture of the livestock sector, the highs have been breathtakingly high while the lows have been desperately low. While 2009, with its high feed costs and general global economic meltdown, can represent the lowest of lows, 2014 surely will remain in the record books for many years to come for the record shattering high. Although either of these years could be duplicated again, the probability of either of these years occurring again soon is low.

Extreme livestock market volatility has become expected by all. Long-term survival may depend critically on risk management plans adopted by individual operations. Marketing livestock or milk using a cash market strategy is a risk management strategy that works well in rising markets but provides little help in declining markets.

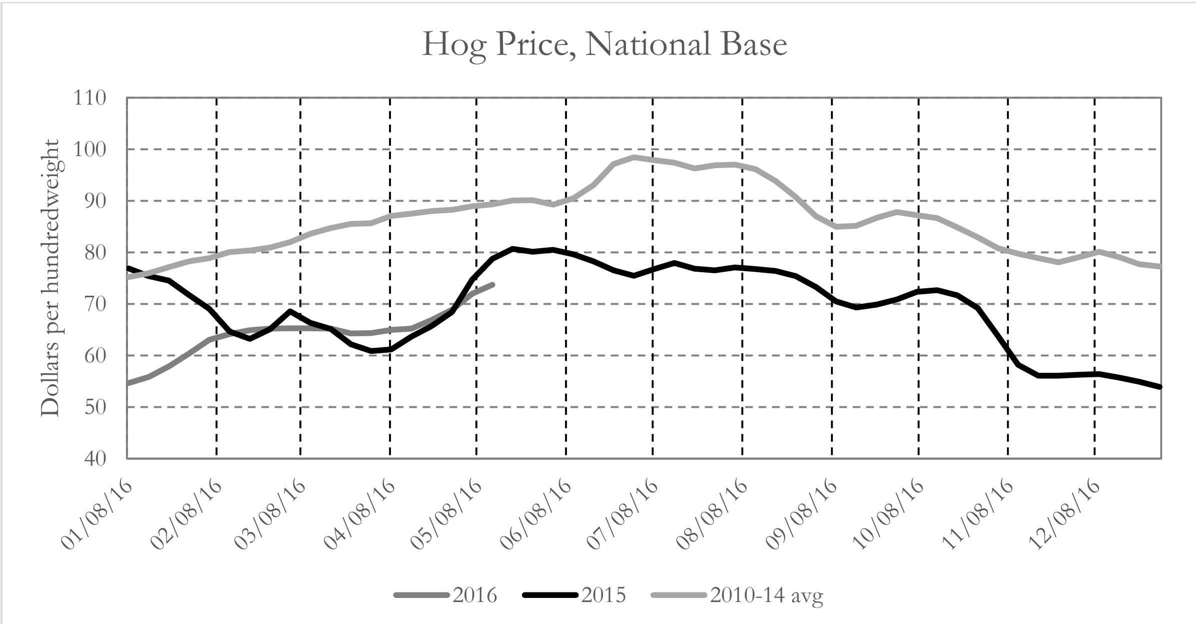
Cattle markets have seen the droughts of 2011 and 2012 in major areas of cow-calf production in the United States contribute to the record cattle prices in late 2014 and early 2015. Although cattle markets have fallen substantially from the record highs, 2016 will still be another year of positive returns.



Beef cow expansion that began during 2014 and accelerated during 2015 continues in 2016. The decline in current economic incentives will likely slow future growth in beef cow inventory. The one million head annual growth in beef cows that was reported by USDA for January 1, 2016 was the largest increase experienced in over two decades.

As beef production continues to expand, cattle prices are likely to come under further pressure over the next few years. For Missouri combined auctions, 450 to 500-pound feeder steers which reached over $3 per pound in early 2015 but have recently fallen to $1.80 per pound. However, that remains above the $1.25 per pound level seen in early 2010.

Hog producers saw farrow to finish returns hit record levels in 2014 as feed costs eased and PEDv dramatically cut the number of pigs saved per litter. As the sector recovers from disease events, pork production has grown and hog prices have moved lower. Pork production grew by over 7 percent in 2015 relative to 2014 and hog prices declined by more than 30 percent.



The recent growth in barrow and gilt slaughter does highlight the need for additional processing capacity to come on board soon. Current pork processing expansion plans will help handle the flow of additional hogs that will come to market in late 2017. By the fourth quarter of 2016, current processing capacity may be stretched to the limit.

Farrow to finish returns have remained slightly above breakeven in the first quarter of 2016. The return picture for the remainder of this year will depend on the strength of domestic and international demand as well as the size of the U.S. crop currently being planted. If any of these factors raise feed costs or further erode hog prices, the last half of 2016 could be financially challenging.

Dairy producers have seen a similar milk price picture unfold as has been experienced in the other livestock sectors. In September 2014, the U.S. all milk price hit an all-time record at $25.70 per hundredweight. The latest USDA Agricultural Prices report showed that the March 2016 U.S. all milk prices fell to $15.30 per hundredweight. Given current dairy product prices and advanced federal order prices, further declines will occur. This level of milk prices has not been experienced since early 2010.

Two factors have been at play in the decline in milk prices seen by U.S. dairy producers. First, a decline in U.S. dairy product exports has meant increased milk and dairy product supplies on domestic markets. After annual U.S. dairy product exports reached a record of over $6.5 billion in 2014, they fell below $5 billion in 2015. U.S. dairy exports have declined another $0.3 billion in the first quarter of 2016 relative to a year ago. A stronger U.S. dollar and growing supplies in Europe have hindered U.S. dairy exports. Although many in the industry continue to call for a turnaround in U.S. dairy export demand, it has yet to occur. If U.S. dairy exports do not begin to increase in the remaining months of 2016, the financial strain on U.S. dairy producers is going to increase even further.

Second, the expansion in U.S. milk supplies has continued despite the economic stress being felt in the dairy industry. The latest USDA milk production report shows that April milk production growth slowed but it was still 1.2 percent higher than a year ago. The report shows U.S. dairy cow inventories have expanded by 22 thousand head since the start of 2016. The growth in milk supplies is expected to continue into 2017 highlighting the need for U.S. dairy export growth.

The dairy industry needs to carefully consider the inability to turn the spigot off when milk returns suggest contraction is needed. During the 1980s and 1990s, there were more dairy farmers with relatively higher production costs to exit the industry during tough times. By the 2000s, the remaining operations tend to have larger fixed costs, which makes their exit more difficult.

Historical data on U.S. milk production highlights past difficulties in reducing milk supplies when producer returns are low. Since 2000, annual milk production has only declined in 2001 and 2009. Milk production even expanded during the drought-induced record feed prices of 2012/2013. In comparison, annual milk production fell 5 times over the 1986 to 1999 period.

If the assumption of less supply response to poor returns is correct, there are implications that dairy producers must prepare for. Most importantly, the only way out of low returns is for demand growth to catch up to excess milk supplies.

With the current economic downturn in the dairy industry, there has been an abundance of discussion about the new dairy safety net program contained in the 2014 farm bill. There has been growing concern that the Margin Protection Program (MPP) is not providing a strong enough safety net for U.S. dairy producers.

Before examining detailed MPP features, it is important to understand the large task of building a solid safety net program with a tight federal budget. It is extremely difficult to construct a stronger safety net program for dairy farmers while reducing federal spending remains a priority.

The Congressional Budget Office estimates FY2016 dairy CCC expenditures at $42 million and USDA estimates that dairy cash receipts will total $33.2 billion in 2016, a drop of over $16 billion from the 2014 level. Identifying a safety net program for dairy producers that can moderate a $16 billion drop in cash receipts yet only cost $42 million to the federal government is a large challenge.

The MPP has come under scrutiny as milk prices and dairy farmer returns fall. One of criticisms of the MPP is that the current level of the MPP margin, which measures the U.S. all milk price less feed cost, is not representative of what dairy producers face today. For March, the MPP margin was measured at $7.47 per hundredweight which would only provide a payment to those producers that bought coverage at some of the highest levels.

The reduction in feed costs as represented by national corn, soybean meal and alfalfa prices has resulted in the MPP margin falling far less than the decline in national milk prices. Many producers have reported their financial situation has eroded much faster than the MPP margin has declined. It has led to much speculation on the reasons why. A comparison between the costs of corn production and the decline in corn prices is instructive as to some of the issues that are at play for dairy producers.

In late March 2013 the USDA Agricultural Marketing Service (AMS) reported single car unit Chino Valley California corn prices at $8.76 per bushel. By the same period in 2016 they fell to $4.82 per bushel. AMS reported Minneapolis corn prices fell from $7.15 per bushel to $3.23. Larger corn supplies and cheaper transportation allowed for a 45 percent decline in Chino Valley corn prices while Minneapolis corn prices fell by 55 percent. The large declines in corn prices are helpful to dairy producers, yet this direct comparison of corn prices may mask some of the regional effects of dairy feed costs.

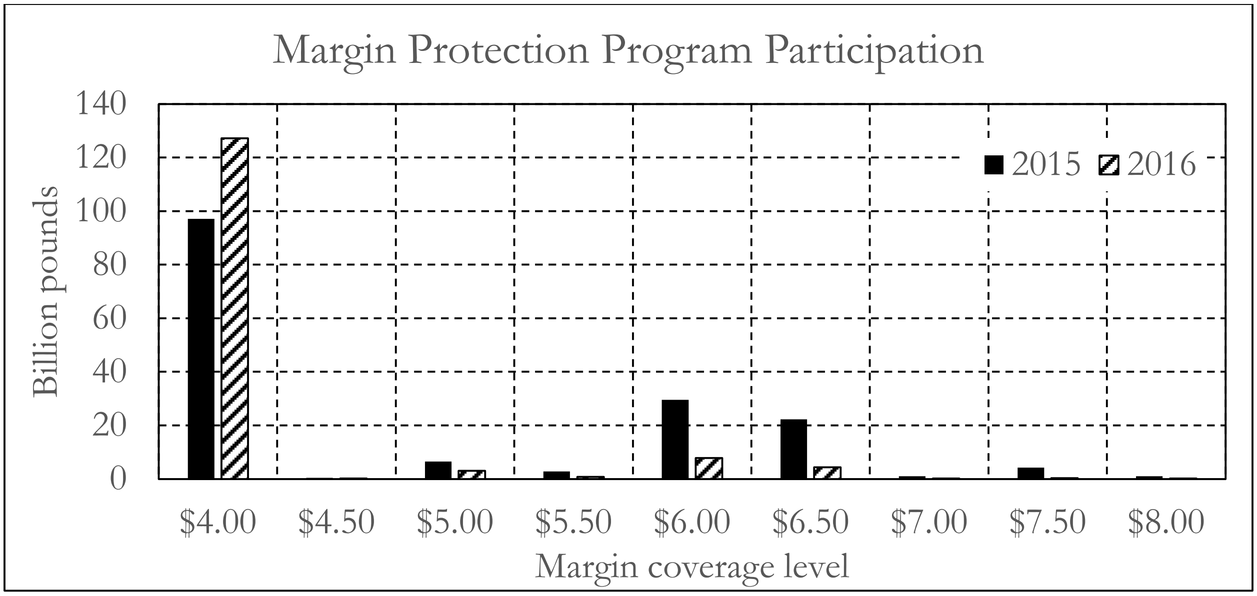
The USDA Economic Research Service (ERS) estimates that 63 percent of Wisconsin dairy farmers' feed costs come from homegrown harvested feed compared to 26 percent in California. Dairy producers that buy a majority of their dairy feed may be in a better financial positon today than those that grow more of their feedstuffs, as the total corn production cost reported by ERS has changed little over the 2013 to 2016 crop seasons. ERS reported 2013 total corn production costs at

$676.66 per acre while they estimate 2016 at $679.72 per acre. The situation has changed rapidly relative to a few years ago when those growing their own feed were in a better position to manage historically high corn prices.

The difference in the cost of growing feed needs for the dairy and the decline in crop prices may be one of the reasons dairy producers have struggled with the safety net provided by the MPP. There has also been discussion around the coefficients that derive the national feed cost used in the MPP formula. The National Milk Producers Federation (NMPF) had a taskforce of industry experts construct rations representative of the dairy industry back during their development of the Foundation for the Future program development. This work constructed rations made up of corn, corn silage, soybean meal and alfalfa. Corn silage was converted to a corn equivalent by valuing a ton of corn silage at 10.1 multiplied by the price of corn per bushel.

These original coefficients were modified by reducing them by 10 percent to reduce the MPP program cost during debate on the farm bill in 2013. This was a period of time with very high crop prices and many baselines kept crop prices at much higher levels than we are experiencing today. The effect of this change was to lessen the effect of feed prices on the overall MPP formula. If these coefficients had not been adjusted lower, the criticisms of the formula would only grow as feed would have a larger effect and the decline in feed costs would even offset a larger proportion of the milk price decline.

The MPP was a major change in dairy policy relative to the past safety provided to the dairy industry. The move to policy focused on providing margin risk management from one that provided a floor on milk prices has required moving from an attitude of program return maximization to risk management. More work is needed to help producers think through the risk management aspect of the MPP. 2016 MPP participation has moved to the lower levels of margin coverage when producers may be better served to participate at higher levels.



There is a fine line that must be traversed in setting parameters of federal dairy policy. We have had experience with programs that provided too much support to the industry and resulted in large milk surpluses and chronically low milk prices or large government expenditures. Everyone in the dairy industry did not like these periods. However, setting support too low means it may never trigger in those periods of times that it is most needed. This tradeoff will always require modifications as future farm bills are debated and passed.

In summary, it remains clear that U.S. meat and milk supplies are going to continue to increase perhaps well into 2017. Global demand and strengthening U.S. meat and dairy exports will be needed to move livestock and dairy market prices higher. Strong domestic demand must continue as well. Federal livestock and dairy policies must address the added volatility that comes as a result of more emphasis on global markets. Weather will remain another big risk for livestock producers and the support provided by federal programs like the Livestock Forage Program (LFP) are a much needed help against catastrophic weather events.

Mr. Chairman, thanks for the opportunity to discuss the many issues facing the livestock and dairy industries today.