House Committee on Agriculture
Subcommittee on Livestock and Foreign Agriculture

Addressing the State of the U.S. Dairy Economy

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Good morning Chairman Costa, Ranking Member Rouzer and distinguished members of the Subcommittee. Thank you for the opportunity to provide my perspective on the current state of the U.S. dairy economy.

Today's dairy farmers face challenges on multiple fronts, but also great opportunities. U.S. dairy is a dynamic and innovative industry made up of approximately 39,000 dairy farms and slightly more than 1,300 processing plants that support nearly three million U.S. jobs, generate more than $161 billion in wages and has an overall economic impact of more than $628 billion. As the fifth largest commodity in the United States, dairy generated $36.7 billion in sales in 2017. Mr. Chairman, as you are fully aware, our home state of California remains the leading dairy state, producing 18 percent of the country's milk.

The U.S. dairy industry has amazing potential and is ready to meet the growing domestic and international demands. U.S. dairy farms are getting better and becoming more efficient at finding innovative ways to produce more with less. U.S. farm milk production has grown from 170 billion pounds of milk in 2003 to 218 billion pounds in 2018 and milk production per cow has increased by more than 35 percent since 1998. Today that means that the average cow is producing 23,150 pounds of milk per year. This growth in milk production means that we have more milk than is needed domestically, which presents an economic vulnerability. It also means that our industry is poised to meet a growing global demand for dairy products at a moment's notice, presenting great opportunities for our dairy industry.

Today I will focus my testimony in four areas. First, I will provide a short introduction of California Dairies, Inc. (CDI), and next I will offer examples of current issues facing our industry today. Third, I will describe our focus on the current trade landscape, and finally I will outline some solutions and suggestions to improve the overall business health of our dairy farmers.

<u>California Dairies, Inc. (CDI)</u>

Headquartered in Visalia, CA, CDI is the largest dairy farmer-owned cooperative in California and the second largest in the United States. The cooperative was formed in 1999 to sell, market and add value to our member's milk. Our 360 family-owned dairy farms produce almost 16 billion pounds of milk per year representing 7 percent of all milk produced in the United States. Every day we pick up between 850 and 1,000 truckloads of milk from our farms. Half of these truckloads are delivered and sold to bottlers or the milk is used as an ingredient in other dairy products, primarily cheese. The other half of our milk goes into our own manufacturing facilities.

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CDI member farmers have made a large financial investment in seven manufacturing facilities to process milk into transportable products, primarily milk powder and butter products. Not only do these farmer-owned manufacturing facilities ensure a home for the milk our members produce, but they also are the key to balancing the steady milk production on the farm with variable customer demand – a key function of CDI and other manufacturing cooperatives that often gets taken for granted.

Our cooperative is the largest producer of retail butter in the United States. We manufacture almost 400 million pounds of butter a year – more than one pound for each person living in the United States. We wholly own Challenge Dairy Products, Inc., the number one branded butter in the western United States. Nearly all of our butter is sold to U.S. consumers with exceptions when pricing conditions are favorable for export.

CDI is the largest producer of milk powder in the United States and the largest producer of skim milk powder in the world. We produce about 700 million pounds of milk powder per year. Our exports of milk powder have grown over the years and are now reaching sixty percent of our total production. Clearly, we are highly dependent on global trade and U.S. trade policy. CDI sells and markets our milk powder through DairyAmerica, which is a federated cooperative made up of three other farmer-owned U.S. dairy cooperatives located across the country.

Current Industry Issues

The U.S. dairy industry has been stressed for several years due to low margins and low worldwide prices. The dairy industry is unique within the agricultural sector. Almost all of the remaining U.S. dairy farms are family run businesses. Our dairy families work very hard and operate 24 hours a day, seven days a week, and 365 days a year. The supply of milk is constant, but demand varies weekly.

These farms produce a highly perishable year round "crop" with some seasonal swings in supply – specifically in the spring. This supply requires adequate milk processing capacity. Some regions of the country lack this capacity. Additionally, processing assets must also have the capacity to process the short spring flush peaks in milk production, leading to inefficiencies during non-peak periods when such capacity is not needed.

The dairy industry continues to see consolidation, similar to other sectors of the economy. Between 2012 and 2017 the number of U.S. dairy farms contracted by 15 percent. Smaller farms with herds fewer than 100 cows declined by 29 percent contrasted with farms with over 2,500 cows growing by 24 percent. Over this period, the total U.S. dairy herd increased by three percent or over 280,000 head. Cows have also become more productive over this time period as dairy farmers have excelled in employing advancements in herd health, genetics and feeding practices to produce more milk with fewer resources. The end result is that more of the U.S. milk is produced by fewer, larger and more productive operations.

All dairy farms operate on a profit margin determined by operating costs on their farm and general market pricing. The U.S. domestic prices are highly influenced by global prices and the global supply-demand balance of milk. The U.S.is no longer isolated from world prices. Price volatility has doubled over the last five years making many of our farmers experts in utilizing financial risk management tools.

Global milk and dairy product prices have been depressed over the last three years resulting in low or negative margins and subsequently leading numerous farm families around the U.S. to sell their businesses. These on-farm losses combined with reduced market values for dairy cows are stressing bank relationships.

The operating cost side of the dairy margin equation is driven primarily by feed and labor costs. Almost every dairy farm in the U.S. has labor availability issues today. Milking cows is difficult, and the job requires significant training and skill. Immigration policies will have a substantial impact on our industry. An effective agricultural guest worker program that meets the year-round needs of the dairy industry is needed.

International trade is a critical component of the U.S. dairy economy. Sixteen percent of U.S. milk production is exported. About one day a week our farmers produce milk that is destined for export markets. Thousands of jobs are dependent on U.S. dairy exports.

Trade Policy

Due to the dependence on exports and world prices our dairy farm incomes are highly entwined with trade policy matters, meaning that expanding exports are vital to the health of our farms, and trade conflicts that limit our ability to sell products around the world are extremely damaging. It is a fact that a much-needed recovery in U.S. milk prices was halted in 2018 due to trade retaliation tariffs with Mexico and China.

Our biggest competitors producing milk and dairy products for the export markets are the European Union (EU) and New Zealand. Secondarily, Canada, Brazil, Argentina, Uruguay, Australia and India would round out the competitive set, although on an infrequent basis. The most valuable export markets for our industry are Japan, China, and Southeast Asia, followed by the Middle East and Africa.

In 2018, the United States exported $5.58 billion of dairy products, from cheese to whey to ice cream to skim milk powder and everything in between. Free trade agreements that open markets and lower trade barriers are crucial to continuing this trend of growing U.S. dairy exports.

Dairy farmers are acutely aware of trade policy developments because today, their livelihoods increasingly depend upon global markets opportunities. It is particularly damaging from a dairy perspective that the U.S. has fallen behind in negotiating trade agreements, especially compared to trade agreements negotiated by the EU and New Zealand, our primary competitors. Some examples of such agreements are the EU-Japan Economic Partnership, the EU-Vietnam Trade Agreement, and the New Zealand-China free-trade agreement, which puts us at an increasing disadvantage with the world's largest market. The Trans-Pacific Partnership (TPP) going ahead without U.S. involvement has affected our competitive position in a key region.

The U.S. has not completed and passed a new trade deal in well over a decade. The EU has trade agreements completed or in process with nine of the top ten dairy importing countries while the U.S. has four. Likewise, New Zealand has trade agreements with most Asian countries where demand is growing at a rapid pace. The U.S. trade agreements that are in place today were negotiated before other agreements, and do not always place the U.S. on a level playing field with our competitors, putting the dairy industry at a comparative disadvantage

Trade Agreements:

Dairy industry priorities in U.S. trade agreements are fairly straightforward. First and most importantly, a fair and level playing field is critical. The United States provides large export markets in many sectors to our trading partners, and we must insist upon securing more favorable export market access than what our competitors have been granted through prior treaties. Some concerns include tariffs in China and Vietnam, competitors benefitting from government interference (Canadian - Class 6/7) and the EU intervention programs that distort and delay global dairy price recovery.

Second, any trade agreement should include robust access for the "whole bucket of milk" – all dairy products across the board. Too often, trade agreements isolate dairy market access to a limited subset of dairy products, typically cheese and whey. The U.S. dairy industry needs market access for products made from all components in milk.

Let me take a moment to comment on current negotiations.

United States – Mexico – Canada Agreement (USMCA):

Mexico is the top market for all U.S. dairy exports, valued at $1.4 billion in 2018. Canada is second with $697 million in export sales. The deal as negotiated meets the dairy industry's top priorities, eliminates Canada's trade-distorting Class 7 pricing program, improves market access into Canada, and preserves our access into Mexico. The agreement contains strong provisions on sanitary and phytosanitary measures and has strong provisions on geographical indications that serve as an excellent precedent from which to build a more extensive list with additional trading partners. These are a number of reasons why we urge swift congressional approval of this agreement. Furthermore, failure to pass the USMCA could hinder the Administration's ability to finalize other trade agreement, because it could be viewed as an inability of the U.S. to get trade agreements through Congress

Last July, Mexico imposed a 25 percent tariff on U.S. cheese to retaliate against Section 232 tariffs. This created significant turmoil for U.S. cheese manufacturers and the producer community having a direct impact in lowering milk prices. Mexico is the largest customer for U.S. cheese exports. Between July and December 2018, volume sales of U.S. cheese to Mexico fell one percent and the value of U.S. cheese exports declined eight percent due to these tariffs.

China:

China has been the third largest export customer for U.S. dairy, with the business valued at $502 million in 2018, down $77 million from the prior year. While the opportunities in China are significant, the U.S. in the past has not been on a level playing field with its competitors from New Zealand or Australia. Equal access in a trade agreement with China would present a large opportunity for the U.S. dairy industry.

This past year, China issued retaliatory tariffs that included essentially all U.S. dairy products. This resulted in U.S. cheese and whey exports declining 40 percent year-over-year. Today, U.S. milk, cream, yogurt, whey, butter and cheese face a 25 percent retaliatory tariff, while lactose and infant formula face up to a 10 percent retaliatory tariff. We are now seeing a precipitous decline in U.S. dairy exports to China, including business that took years to develop.

While the opportunities in China are significant, the U.S. in the past has not been on a level playing field with our competitors from New Zealand or Australia. Restoring our full access to the Chinese market is essential to the health and growth of producer companies and supplying farmers. Yet restoring access is just the first step. Provisions in the free trade agreements New Zealand and Australia enjoy with China give both countries a critical leg up in this large and fast-grown market. Equal access for the U.S. in a trade agreement with China would present a large opportunity for the U.S. dairy industry.

Japan:

Japan is the fifth-largest country for U.S. dairy exports, valued at $270 million in 2018.

Currently, U.S. dairy exports face high tariffs, limited tariff-rate quotas (TRQs) and other barriers to trade in the Japanese market. Market access in any bilateral trade agreement must match or exceed that achieved under the TPP and the new EU-Japan agreement for the U.S. dairy industry to be at a minimum on a level playing field. Furthermore, the agreement must include an accelerated phase-in of tariff reductions to ensure the U.S. is not facing a disadvantage on tariff or TRQ quantity access compared to other countries. Non-tariff barriers, such as sanitary and phytosanitary measures, biotechnology, TRQ administration, and geographical indications, must also be addressed.

Agricultural products and dairy must be addressed in any free trade agreement with Japan.

European Union:

In 2018, the EU exported nearly $1.7 billion in dairy products to the United States, but U.S. companies exported just $145 million in dairy products to the EU. The European Union has the potential to be a significant export market for the United States, but high tariffs and other non-tariff barriers such as burdensome import licensing and certification requirements stand in the way.

We cannot afford to set a precedent of negotiating FTAs with any trading partner that sidelines agriculture. A free trade agreement with the EU must be comprehensive in scope and provide meaningful market access for agriculture. Further, it must address all existing tariff and non-tariff barriers that block our exports, including the geographic indication threat to common cheese names that are currently in use. Without a thorough and robust agreement that uproots this full set of complex barriers to US dairy exports, an FTA with the EU would quite likely deepen our significant dairy trade deficit with the EU rather than narrow it.

Short term Industry Solutions

As just discussed, a key to improving both the short and long-term outlook for U.S. dairy farmers is expanding the number of trade agreements that include increased dairy market access. This includes Congressional approval of the USMCA, concluding Administrative negotiations with China and Japan, and expanding further opportunities in the EU and other South Pacific countries. The U.S. must pursue a robust trade agenda that expands opportunities as well as preserves market access.

Another policy proposal that has great potential for improving the state of the U.S. dairy industry is establishing a national enhanced standard for fluid milk products. This proposal, which has been discussed over the years and was recently analyzed by one of the witnesses here today – Dr. Scott Brown – looks at the potential benefits of adding additional nonfat milk solids to fluid milk products that have had some or all of the milkfat removed. This ensures that consumers drinking these reduced/low/non-fat milk products are getting a wholesome product with additional nonfat nutrients replacing the milkfat that has been removed. This would provide the consumer with a better tasting and healthier product, and secondarily, would increase demand for milk solids resulting in a higher price for U.S. dairy farmers.

The Federal Milk Marketing Order is also in need of modernization. Key areas of focus include more accurate and faster market signals back to farmers on global pricing and marketing conditions through the National Dairy Product Sales Report. Adjustments also could be made to encourage new processing capacity to adequately handle growing domestic milk production.

Summary

The dairy industry is a significant part of the U.S. economy. Dairy farmers have been stressed by low margins and the industry is undergoing rapid change. Trade policy is a vital part of the success for the dairy industry in the U.S. Our industry needs increased access to markets, a greater number of trade agreements and a level playing field. The U.S. dairy industry envisions a bright future capitalizing on opportunities in the global marketplace.

I would like to comment briefly on the Farm Bill and recent legislative activity with respect to dairy. The Farm Bill dairy provisions regarding Federal Milk Marketing Order Class I pricing and the new Dairy Margin Coverage program were well received by the industry and are a positive step forward. The Dairy Revenue Protection Program is also a great enhancement to farmer risk management options.

Again, thank you for the opportunity to testify before the Subcommittee. I look forward to answering your questions and engaging in meaningful discussion about how to maximize the potential of this great U.S. dairy industry.