Testimony to the House and Senate Agriculture and Rural Affairs Committees
Joint informational meeting on Pennsylvania dairy industry issues

Russell C. Redding, Secretary, Department of Agriculture

August 17, 2016

Chairmen Causer, Carroll and Vogel; Chairwoman Schwank; and distinguished members of the House and Senate Agriculture and Rural Affairs Committees, thank you for the opportunity to provide testimony today on several Pennsylvania dairy issues.

I will provide a general overview on the current state of Pennsylvania's dairy industry, outline several key challenges that our dairy farmers have faced in recent months and will continue to face throughout the remainder of 2016 and beyond, share a few key accomplishments as it relates to the industry, and close by highlighting the Department's thoughts on House Bill 1265. While there are many issues we could discuss, the most important is profitability. Current margins indicate producers are making considerable sacrifices to weather the current downward prices.

Market Update

Dairy is a key economic driver within Pennsylvania, serving as the largest sector of the agricultural industry and generating more than $7 billion in economic activity for the commonwealth annually. Across the food supply chain, dairy supports more than 60,000 jobs, with Pennsylvania's 7,000 dairy farms serving as the anchor in many rural communities across the state.

Recently, milk prices at the farm level have fallen nearly 50 percent, with the All-Milk Price in April 2016 at $15.00 per hundredweight ($1.29 per gallon), which is nearly $10 below where it was in 2014. A recent study conducted by Penn State University shows the average breakeven milk price on Pennsylvania dairy farms at $19.10 per hundredweight, which means on average, dairy farms are losing about $4 for every one hundred pounds of milk they produce. The average production in Pennsylvania is about 70 pounds per cow per day, which means that the average 70-cow dairy is losing about $196 per day at the current margin level.

Despite prices, milk production in the Northeast and nationally is up 1.8% from last year, which has placed additional downward pressure on farm milk prices. Dairy exports as a percent of U.S. production have dropped from a high of almost 18% in 2014 to about 12% this year. Global milk production is also up significantly, partly as a result of the European Union's decision to remove its milk production quotas and the loss of their export market to Russia. Furthermore, we are seeing an increase in production in other major milk-producing countries that have led to these depressed prices globally. All of this has resulted in a dairy market in the U.S. and globally that is producing much more milk than can be consumed.

Challenging economic times often remind us of the importance of meaningful risk management programs. The Dairy Margin Protection Program (MPP), established as part of the 2014 Farm Bill, which was a transformative shift in national dairy policy, is intended to provide a safety net when prices fall below breakeven levels. At its base level, the program is to provide catastrophic coverage with buy-up levels providing greater protection at a premium. However, the program has not worked effectively as the National Average Feed Cost Formula, which is a one-size-fits-all-type approach, and does not reflect higher feed costs in the Northeast and other regions of the country. Nor does the national formula take into account transportation, labor costs and other middleman expenses.

Although many Pennsylvania producers purchased MPP insurance last year above the $4.00 margin level, dairy producers received very little by way of insurance payments. Payments were only made at the $8.00 margin level and were very small. Therefore in 2016, very few producers opted to purchase insurance above the $4.00 basic margin level. And although USDA announced last week a pay-out of $11.2 million in insurance payments in May and June, few producers have benefited as a result of low sign-ups for 2016. Farms are reaching a breaking point, and yet the only farms receiving any level of payments are those who bought coverage at the fullest level available. The Department is committed to engaging in risk management program discussions with dairy industry partners and Pennsylvania's congressional delegation as we move into 2017 and begin developing our dairy policy under the next federal Farm Bill.

In an effort to help curtail the challenges outlined above, last month Senator Casey led an effort among House and Senate colleagues to send a bi-partisan letter to USDA Secretary Vilsack. Sixty-one members of Congress, including eight from Pennsylvania signed the letter, urging the USDA to use its secretarial authority under the Commodity Credit Corporation Charter Act, Section 32 of the Agricultural Adjustment Act of 1935, and look to past precedent for how to take action to protect all of our nation's dairy farmers from further crisis and to aid in the expansion and maintenance of domestic markets. The letter encourages USDA to take any and all actions available in order to make an immediate market injection and offer financial assistance that will directly support U.S. dairy farmers equally, while being cautious not to stimulate overproduction further. We are hopeful for a positive outcome.

Certainly the current economics of dairy are challenging, requiring all of us to do everything we can to ensure that Pennsylvania's dairy industry can remain competitive and profitable. We know our farmers can compete in the marketplace and that current prices are more a result of export declines than domestic factors, requiring active engagement of our federal agencies on trade and monetary policy. Dairy producers are working hard to find solutions and if history is any lesson, they will succeed. For these reasons, moving forward, we continue to see great potential for dairy in Pennsylvania to evolve, expand and be profitable.

Highlights

In May 2016, Governor Wolf and the General Assembly put Pennsylvania's milk producers and haulers in a much stronger competitive position relative to other states with Act 34 of 2016. Act 34 provides long-sought-after reforms by enabling PennDOT to issue milk-hauling trucks weighing more than 80,000 pounds special permits to travel on Pennsylvania's interstate highways. Previously, federal law limited how states could treat bulk milk shipments, effectively banning them from most of the commonwealth's interstate highways, but that limitation was removed in December after President Obama signed the Fixing America's Surface Transportation (FAST) Act. These new special permits will allow more milk to be shipped with fewer trucks, reducing the cost of moving milk to processors before reaching the market. Without these special permits, Pennsylvania's producers were at a competitive disadvantage because dairy producers had to rely on more trucks and more frequent trips to move a comparable volume of product, which led to higher costs to the in-state producer.

The Center for Dairy Excellence has a proven track record of resources for dairy farmers and strong support for individual dairy farm families and the broader dairy industry in Pennsylvania. Since January 2015, the Center received 167 new applications from dairy farms for help in establishing a consultant or team of advisors to help their business with profitability, succession planning or incorporation of new technology such as bio-digesters. These team programs guide decisions that have resulted in an investment in the farm business, with the 167 farms' improvements collectively generating an additional $22 million in annual economic impact for the commonwealth. The Center also administers the Dairy Leaders of Tomorrow program, which has doubled in enrollment and now includes 10,500 students in more than 140 classrooms. Finally, the Center continues to guide industry-wide discussions on issues such as environmental permitting, economic development and business profitability.

We are also ensuring an appropriate tax structure for agriculture. The 2016 tax code bill included an exemption from realty transfer taxes for those operations that have an agriculture conservation easement. This provision will prevent a crippling effect on Pennsylvania's nation-leading farmland preservation program. There are 1,500 applicant farms on the backlog list waiting to be preserved and hundreds of easement purchase agreements pending final signature that could potentially be affected if subjected to realty transfer taxes. Additionally, Governor Wolf expanded the scope of the family farm inheritance tax exemption to include all business structures and trusts solely for members of the same family.

And dairy farmers have taken great strides to partner with the state's charitable food system, providing milk and other dairy products to families in need through a partnership called Fill a Glass with Hope. This program has received national recognition as the first-of-its-kind statewide charitable fresh milk program in the country. It is poised to provide 2 million servings of fresh milk in 2016, purchased directly from local dairy businesses. The program began as a pilot in 2014 in a partnership between the Central Pennsylvania Food Bank, Harrisburg Dairies and the Department of Agriculture. Sustaining and strengthening the dairy industry while also providing a highly in-demand product to food bank clients are some of the key foundational principles upon which this program was built. The Fill a Glass with Hope program reached an important milestone in July, expanding to all eight Pennsylvania Feeding America food banks.

<u>Transparency and Trust</u>

Moving forward, the dairy industry must take full advantage of Pennsylvania's state pricing authority. The premium that our commonwealth places on Class I milk produced, processed and sold in Pennsylvania is a benefit. The Department supports efforts that establish trust, built on transparency (and equity) in the way Pennsylvania Milk Marketing Board (PMMB) mandated premiums are reported to dairy farmers. As we are asking Pennsylvania consumers to pay a premium for this milk, we believe it is also important that Pennsylvania farmers know the value of this premium to them.

To accomplish this, the premium should be recognized, and be made transparent on all Pennsylvania dairy producer milk checks. In the spirit of transparency and accountability, all producers should be able to clearly see that benefit. However, a few amendments are needed to House Bill 1265 in order for the bill to achieve its overarching objective of transparency.

As currently drafted, the bill would do little to help dairy farmers who are cooperative members to understand how much they are actually benefitting from the over-order premium. State and federal law allow a cooperative to blend the net proceeds of all its sales and to distribute the proceeds among its producers according to agreements between the cooperative and the producers. And because the bill does not require the cooperative to show how much over-order premium it actually received, any amount shown on a cooperative member-producer's check attributable to the over-order premium is an arbitrary number which may or may not reflect what portion of the over-order premium that the cooperative actually received was distributed to its members, whether in the form of a line-item payment, the base price or other premium payments.

The Department recognizes the fact that cooperative members will never receive a milk check that looks exactly like an independent shippers' (producer) milk check, for a number of reasons. By law, as well as written membership/marketing agreement among the farmer-member-owners, a cooperative can blend and re-blend the receipts and expenses of milk marketing and divide the proceeds among themselves as they see fit. In practical terms, this means that cooperatives do not necessarily have to pay the same minimum price(s) monthly to members as a proprietary dealer/handler.

The Department had previously proposed an amendment to the bill which would allow cooperatives to show, on a per hundredweight basis, the total amount of the state-mandated premium dollars received by the cooperative divided by the total production of the cooperative's Pennsylvania producers during the payment period. This would have allowed cooperative members to see, on average, how much each member was benefitting from the state-mandated premium, whether in the form of an increase in the base producer price or additional identified premiums.

The Department amendment also included language to recognize the costs cooperatives incur to help balance the market. Cooperatives provide a valuable benefit to the Pennsylvania dairy industry in the form of lab testing, field work, balancing and other services that they perform when procuring milk for milk dealers. The value of this service should be recognized, in addition to requiring any payment made to a farmer clearly delineate the dollar amount of the total that consists of monies collected form the state-mandated over-order premium. The Department looks forward to working with the General Assembly and the dairy industry to ensure the highest level of transparency and equity in the way premiums are reported.

Summary

In closing, we have a great challenge ahead of us as we think about the current state of Pennsylvania's dairy industry, pricing and market challenges and an appropriate safety net for producers. That being said, we have much to be proud of in our dairy industry. Dairy farmers and the industry are resilient. We have many strengths -- our diversity, our ability to produce a high-quality product, our geographic proximity to large population centers and markets and our ability to grow. The Department stands ready to help the industry capitalize on these strengths and opportunities, and work with producers and other stakeholders to navigate the challenges outlined here today. Thank you for the opportunity to provide input and for your continued support of Pennsylvania agriculture.