REVIEW OF FEDERAL FARM POLICY

HEARING

BEFORE THE

SUBCOMMITTEE ON DEPARTMENT OPERATIONS, OVERSIGHT, DAIRY, NUTRITION, AND FORESTRY

OF THE

COMMITTEE ON AGRICULTURE
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WITNESSES

REVIEW OF FEDERAL FARM POLICY (DAIRY)

SATURDAY, SEPTEMBER 16, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
OVERSIGHT, DAIRY, NUTRITION, AND FORESTRY,
COMMITTEE ON AGRICULTURE,
Fresno, CA.

The subcommittee met, pursuant to call, at 9:00 a.m., in the Hall of Records, Fresno, CA, Hon. Gil Gutknecht (chairman of the subcommittee) presiding.

Present: Representatives Cardoza, Costa.

Also present: Representative Nunes.

Staff present: Ben Anderson, subcommittee staff director; Lisa Shelton, minority professional staff.

OPENING STATEMENT OF HON. GIL GUTKNECHT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. GUTKNECHT. I will call to order this hearing of the Subcommittee on the Department of Operations, Oversight, Dairy, Nutrition, and Forestry for purposes of taking testimony on the state of the dairy industry here in California and begin to collect more information and input about what kind of a farm bill we will have.

The farm bill, as many of you know, technically expires at the end of the growing season next year. Of course, there is discussion about whether we should extend it, whether we should amend it, and what ultimately will happen I think would be conjecture on anybody's part. If we are talking about dairy policy, it is important that this subcommittee come to California.

As Devin Nunes told me a couple of years ago, and I apologize that I did not know up until that point, that you actually produced more milk in just one county, Tulare County, than we do the whole State of Minnesota. We like to think we are a pretty good dairy State in the State of Minnesota, the State that I represent.

Let me also just tell you a little bit about the subcommittee. We do have wide-ranging responsibilities. We have oversight, for example, over the nutrition programs. We will spend about 40 billion of your taxpayer dollars this year to make certain that no one in the United States goes to bed hungry. I think that has been a tradition of the Agriculture Committee for many, many years and I think it is something that most Americans support.

Let me just say we have had hearings on that subject of this subcommittee in the past and we are doing a better job of managing those funds today than ever before. In fact, in every one of the 50

States now we no longer have the old food coupons that you think of in terms of food stamps. We now use debit cards. That is not to say we can't have fraud but we are much better at managing those funds and how the funds are actually spent than ever before.

We also have responsibility for oversight of the entire Department of Agriculture. The Department of Agriculture has 110,000 employees. It is the second largest department in the Federal Government. I can't say that it is the model of efficiency but we are trying every day to make it more efficient and more responsive not only to farmers and ranchers but to the general public as well.

We also have oversight over the national forests. Sometimes people are surprised. People who don't follow agriculture or whatever are surprised that the Forest Service is under the wing of the Department of Agriculture.

There is a real important reason for that and that is over 100 years ago the Congress recognized that trees were crops. We could probably have more hearings just on how we are doing in terms of managing the forest but we are so busy with other subjects we have only had one hearing to discuss that and meet with folks from the forest industry.

Finally, we are here today to talk about dairy. Of all the issues that we deal with in this subcommittee and on the entire Agriculture Committee sometimes the thorniest of which is dairy. Of course, there are some reasons for that because the one commodity, if you will, that has become regionalized and fractionalized and it started back in 1934 with the Milk Marketing Order System. It is a little less complicated than it was then but it is still one of the most complicated parts of agricultural policy. It is one of the only areas where we literally pit regions against regions sometimes so it becomes quite controversial.

I want to thank my colleagues from the State of California for helping to set this up. It is a meeting we have been trying to put together for some time and I wanted to do it yet this fall so we are fortunate to be here when the weather is so wonderful here in Fresno County so I want to thank all of you.

Mr. CARDOZA. It is always this way.

Mr. GUTKNECHT. The last time I was here it wasn't quite this hospitable.

With that, I want to recognize Representative Cardoza for any opening statements he may have.

OPENING STATEMENT OF HON. DENNIS CARDOZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. CARDOZA. Thank you, Mr. Chairman. We really appreciate you coming to Fresno and holding this hearing here. In Fresno County and through the Central Valley agriculture is the driver of our economy and dairy consistently ranks as the top producer in that agricultural economy.

I and my colleagues here with yourself have participated in numerous Agriculture Committee hearings regarding the 2007 farm bill throughout the country including the one that Mr. Pombo hosted in Stockton. This hearing, though, gives us the focus on this prized industry that we have in dairy and what we can do to improve our Nation's dairy policy as we go forward.

The Dairy Price Support Program provides a safety for dairy producers and also benefits consumers in the marketplace. It is also one of the farm programs that does allow the Federal Treasury to recoup its inputed cost into the program.

We also have tremendous challenges in California. I would like to speak briefly about the regulatory challenges that face the dairy industry. We have more than our fair share of environmental compliance issues including air quality issues, water quality issues, endangered species impacts, water supply impacts. We need to focus on all those things as we go forward in the farm bill and that is going to be an integral part of what we try and write into that act.

Undoubtedly there will be an energy title in the farm bill as well. this will present us both with some unique opportunities to turn some of these challenges into opportunities and the dairy industry must be ready to seize on them.

We were up in your neck of the woods not too long ago and I was amazed to see the agricultural economy really booming there driven mainly by investments that you all have made in alternative energy, the ethanol that was being produced, the vision that you have towards cellulosic ethanol production. Although it is in the R&D stages right now, some of those technologies and innovations are really moving your economy and I think that can happen here in California, too, if we do it the correct way.

Historically, as you know, Mr. Chairman, California hasn't received its fair share of funding under the farm bill. Under the 2002 farm bill California ranks sixth amongst States receiving Government payments and 12th amongst States receiving conservation funding. Even though we have the most environmental conservation challenges and we have the highest amount of production in the country, we are sixth and 12th.

That needs to change and the farm bill offers unprecedented opportunity to make this change by expanding upon existing programs that work for the dairy industry such as the EQIP program. We also need to take an increased look at research because through research and innovation we will be able to meet some of these challenging environmental issues.

With regard to trade, because the continuing challenges that we have seen with trade and equities, we must look for opportunities in the farm bill to increase market access to new and expanding dairy markets such as with the dairy export incentive program and to provide for an assessment of imports that currently benefit our research and promotion programs here in the United States.

Finally, today we are also here to talk about disaster assistance. This summer the California dairy industry suffered devastating losses. Two or 3 percent of the herds, 1 to 2, maybe 3 percent in some cases of herds, were devastated by the extreme heat. The dairy industry suffered over a billion dollars in animal loss and milk production.

Both the State and Federal Governments have declared extreme temperature disasters and that has cleared the way for Federal funds. Those funds, however, don't come automatically, as you know, Mr. Chairman. We are looking for existing funding options within USDA and it looks like the best chance right now is the disaster package that is moving through the Senate. We are hopeful that we can be included in that legislation.

I am very proud to be here with you today and welcome you to the Central Valley and look forward to hearing the testimony of these distinguished panel that we have before us today. Thank you, Mr. Chairman.

Mr. GUTKNECHT. Thank you, Dennis.

Let me just say on that last item I share your view. If we are going to do disaster relief, we should do it now. To that end I actually talked to some of the people in the administration and the chairman and others. I think I sent them a letter on Friday—I hope it went out on Friday—to that extent that we have to get moving on disaster relief on the House side.

With that I am going to recognize Mr. Costa. We were driving yesterday. We got here about 4 o'clock. We actually went up to one of your ethanol facilities to Pacific Ethanol, I think it is called, that they are building. We were going up there it seems to me I was driving on a freeway and we saw somebody's name on the freeway. It was a wonderful very smooth ride. I want to thank you for that and thank you for welcoming us here to Fresno County.

OPENING STATEMENT OF HON. JIM COSTA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. COSTA. Thank you very much, Mr. Chairman. You got on the road before we put the toll booth in. No, it is a nice thing that my colleagues did in a previous life. I think I speak on behalf of all my colleagues that we are pleased that you would take the time as we try to wind up our session here to come to Fresno, to come to our valley, to in this morning's hearing focus on California's dairy industry.

We all collectively believe how important it is as a part of our national agriculture economy. You are with three of the four members of the Portuguese Caucus so we know something about dairy. At least we believe we do based upon our ancestry and our own personal experiences. We are very proud of that experience and we are very proud, of course, of our ancestry and the role that the dairy industry has played as it has grown in California's agriculture economy.

We want to thank you because obviously you could be in your district this weekend and to come here and take the time and to look at not only the efforts within agriculture and dairy here but the efforts we are trying to emulate that you are doing in Minnesota with ethanol that we think is important.

I would like to focus this morning and listen carefully from the witnesses in two areas as it relates to your testimony. First of all, Congressman Cardoza, I think, made good reference to the disaster relief efforts. Congressman Peterson has a measure H.R. 1599, the Emergency Agricultural Disaster Assistance Act of 2006, that would focus to benefit dairymen in a couple of areas which is important.

First, livestock indemnity program for losses due to death and second, livestock compensation program which supplements feed costs to make up for production losses. As our colleague, Dennis just noted, it is just not the 2 to 3 percent losses that were experienced as a result of the heat wave we had in July but when you look at the counties, and we have our agriculture commissioner here and we have the Under Secretary of the Department of Agriculture, numbers that have been compiled in the last several weeks and when we looked at the Valley counties, we have losses as it relates to not just the animals themselves but we think of the loss of milk production, the ripple effect as a result of that following anywhere from the highest of Tulare County, which Congressman Nunes represents of $144 million, to Fresno County which we all represent, $39 million plus Merced County which Congressman Cardoza represents, $77 million.

The totality of the losses in terms of value to the impact of the industry we currently estimate as a result of our agriculture commissioners to be somewhere in the neighborhood of over $456 million. That is obviously a significant loss to an industry that already is suffering from below market prices and higher cost of production prices in every area. Of course, the testimony this morning will bear me out on that.

Beyond what we may be able to do on disaster relief, and I want to commend you for your acknowledgement that it is not only a problem here but throughout the country, and that we should try to act on it before we leave. You will have my support to try to do whatever we possibly can in that instance realizing we only have a couple more weeks before we are scheduled to adjourn.

The other areas obviously, again, Dennis mentioned but they deal with resetting the table for the 2007 farm bill that we are in the midst of dealing with. There is a lot of interest as it relates to various programs that have had success in the 2002 farm bill from EQIP to market access to trade promotion. We want to see flexibility.

We have had hearings around the country. There seems to be broad general support for reauthorizing the 2007 farm bill as we did the 2002 with tweaks and modifications here and there. I am not sure the administration is going to like that because they would like us to come back with a farm bill that was significantly lower in terms of cost. I would like to get your take on what your opinions are. Secretary Johanns has already, I think, indicated where he would like to see us begin in that effort.

Then finally, and I think very importantly, we are going to have an opportunity as was noted to create an energy title in the 2007 farm bill which will be new. It would be the first time that we did that. When we look at the challenges we have had here this summer in California and elsewhere, and I was very pleased when we did go to Minnesota in July to see a 1,000 megawatts of wind energy being developed in your State, Mr. Chairman, as well as a host of other ethanol and agricultural related energy contributions that are being made in your State, we could learn from that effort, I believe, here in California.

The fact is that when you look at digesters, for example, we have over 2,400 dairies in California. If half of those were able to produce digesters, they could contribute not only to their own energy needs but provide energy to the grid. We have a problem, though, in California, and I believe elsewhere.

We are not allowed to provide any excess energy and to put it on the grid. We need to look at how we address that because on the margins, especially when we have shortage of supplies, I think the dairy industry and other industries can contribute as a part of an overall solution and we need to examine how that can happen.

My last point, and I am pleased that we have some of our products here, and we want to make sure that we use all of our milk products. This morning I was trying to do my part to support the industry. I suspect all of you were. But you noted, I think, very correctly that the programs that have occurred on the Federal and within individual States go back to the 1930's to create a safety net.

When Congressman Cardoza first came to the legislature in the late 1990's he was Chairman of the Agriculture Committee and I was his counterpart on the State Senate. I said, "You know, we really need to reexamine the California milk pooling program and we really need to." Some of you were part of that discussion.

I said, "Let's bring the whole industry together and see how we can modify and look at what is good and working and look at those areas that need to be modified or changed." I must tell you we held once-a-month meetings for 10 months. At the last meeting we had 10 months after the first I can tell you we were no further along than we were in the first meeting that we held.

The contention between producers, processors, co-ops and the like, we will see, I think, examined even here within California. It is important for you to note the regional differences that exist. I would like our dairy witnesses that testify this morning to step back for a moment of they could in their testimony and say if you were going to write it all over again how you would instruct us if we were to have three goals.

Let market principles work; two to provide a safety net; and, three to look at a national program that reflected the regional differences in a global economy in which our dairymen must compete.

Now, let me repeat that again. If you were to try to let market principles work unfettered; to try to ensure that we provided a safety net; and three, create a condition under which on a regional basis we could compete on a global basis. If you can tell us how to do that by the end of this hearing today, we will be a lot further ahead than we could possibly imagine.

Thank you very much again for being here.

Mr. GUTKNECHT. Thank you, Congressman Costa.

Next we are going to go to Devin Nunes. Devin is one of the newer Members. Well, not so much newer anymore but I want to thank him for inviting us out here and teaching us more about the California Dairy Association.

Congressman Nunes.

OPENING STATEMENT OF HON. DEVIN NUNES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. NUNES. Thank you, Mr. Chairman. I just want to thank you for your continued support of the dairy industry and your continued commitment to come to California. For those in the audience, he was actually out here, I guess, 3 or 4 years ago originally and we spent a day in Tulare County looking at the industry and it is all something that is a little different than Minnesota, although there is more and more larger farms in Minnesota that keep coming and keeping up with basically just the growth and continued growth in the dairy industry and continued consolidation.

I want to thank the panelists for being here. I told the chairman when he was first here and I had 500 dairymen in my district and you might get a thousand different opinions between the 500. You will see that, I think, here again today, Mr. Chairman, but I think I want to echo Mr. Costa's questioning. I thought that was very good, those three principles. It will be interesting to hear what you guys think.

Obviously I have ideas and these guys have ideas and we would all like to see if we can come up with something that we can add to or subtract out of the upcoming farm bill next year.

With that, thank you Mr. Chairman. I look forward to the testimony.

Mr. GUTKNECHT. Thank you, Congressman Nunes.

Let me just say before we turn it over to our group of witnesses that we have a relatively simple model in my office and on the subcommittee and that is listen, learn, help, and lead. I know that sometimes even my constituents look at me and say, "But you're not listening." What they don't realize, particularly when you start talking about dairy policy, we are listening to lots of people all the time.

As my colleagues have pointed out, they don't always share the same opinion. I often say, especially as it relates to dairy policy, our job is not so much about conflict resolution so much as it is about conflict management. Trying to keep as many of the forces moving in the same direction because I think we all do have the same goal and that is two-fold. First of all, to make certain that people who were involved in this very important part of what I call value-added agriculture have a chance to earn a decent living whether you are in Minnesota or California or wherever you are.

Second, and I think more importantly, is that we don't lose something that we have taken for granted basically since the United States was organized and that is an unlimited supply of young people who are willing to go out and take a chance at this business we call agriculture. We have an important responsibility.

I want to thank my colleagues for being here today and for inviting me to come out. With that I am first going to go to Mr. Richard Cotta who is the senior vice president for government and producer relations for California Dairies, Inc., from Los Banos, California. Welcome, Mr. Cotta.

STATEMENT OF RICHARD COTTA, SENIOR VICE PRESIDENT, GOVERNMENT AND PRODUCER RELATIONS, CALIFORNIA DAIRIES INC., LOS BANOS, CA

Mr. COTTA. Thank you, Mr. Chairman, and members of the subcommittee. In light of your 5-minute limit on testimony, I have written about 20 minutes worth so I will cut it down to 5 and then the other 15 will be somewhere on the paper.

California Dairies is the largest dairy cooperative in the largest dairy State in America. Our co-op is the result of a successful 1999 merger of three of California's most financially successful cooperatives; California Milk Producers, Danish Creamery, and San Joaquin Valley Dairymen, which all had roots dating back to the turn of the 20th century.

Today our producer-owners have over $100 million in equity invested in the co-op.

We ship over 16 billion pounds of milk annually. Our owners have dairies located from San Diego County in the south to Marin County in the north, with most of the production occurring in the San Joaquin Valley from Kern County to San Joaquin County. We also have five processing plants strategically located in our production regions and plant No. 6 is currently under construction in Visalia.

We have two wholly-owned subsidiary: Challenge Dairy Products, and also Los Banos Foods. We are a major shareholder in Dairy America which handles about two-thirds of all the milk powder produced in the United States and we currently export milk powders to over 40 countries in the world.

Dairy Policy and the next farm bill. I appreciate the opportunity to testify about the current status of national farm policy important to dairy cooperatives and our recommendations for the next farm bill. No. 1, trade policy. I think it is important to first talk about the next farm bill in the context of trade.

With the recent events surrounding the Doha WTO round, it looks like there will not be a new trade agreement in place before the next farm bill is written. However, we continue to support the U.S. proposal that was submitted to the WTO back in 2002, which calls for the elimination of export subsidies and correction of inequities in market access and domestic support. The rational for the U.S. proposal is as important and relevant today as it was 5 years ago:

The 1994 WTO Uruguay Round agreement created many trade disparities because many countries were allowed to continue with extensive levels of support, which continue to exist today. These inequities have left the U.S. market relatively open to subsidized competition from abroad, while denying our dairy industry the same opportunities to develop new markets overseas.

Second, the U.S. proposal is designed to correct inequities, through a balanced approach to three key areas: elimination of export subsidies, increases in market access, and reductions in domestic support.

Many of our training partners, the EU, Japan and Canada, still maintain triple digit tariffs that are simply a de facto export ban because the tariffs are so prohibitive.

There are a wide variety of non-tariff trade barriers, sanitary and phytosanitary issues and food labeling, to name just a few, that continue to create barriers for us in finding new markets, and we appreciate the efforts of USTRS and USDA in dealing with these situations when they arise. Absent a new trade agreement, we urge Congress to reauthorize the Dairy Export Incentive Program in the farm bill.

The final issue I want to refer to relating to trade is the import. There are two areas that I want to briefly discuss. The first is the issue of assessing dairy imports for our research and promotion programs. This was included in the 2002 farm bill but never implemented because of concerns of whether it would pass muster under WTO.

We urge Congress to take whatever action is necessary in the next farm bill to get this corrected so that the dairy importers can be assessed their fair share.

The other issue is milk protein concentrates. We think the U.S. policy should be one that encourages and allows growth in our domestic capability to produce MPCs rather than outsource yet another portion of an industry to other countries. This could be achieved by either establishing a tariff on imported MPCs or through some kind of processing subsidies for domestic MPC production.

The Commodity Credit Corporation Price Support Program works and should remain intact. We believe that the current dairy price support program, under which CCC supports the price of milk at $9.90 per hundredweight and the price of nonfat dry milk at approximately 80 cents per pound, have served the industry well and should continue into the next farm bill.

These support levels do not guarantee a profit for any dairy producer; indeed, these purchase prices are still below everyone's cost of production. However, the price support program does give industry an avenue for dealing with situations where supply and demand are out of balance.

We believe the price program also represents a good Federal policy because the benefits outweigh the costs.

The Milk Income Loss Compensation Program should be terminated. The MILC program is fairly divisive within our industry due to the fact that it mainly benefits small producers.

Conservation programs are vital. California and the San Joaquin Valley in particular is at the forefront of just about every environmental issue being faced by agriculture producers today. We are very supportive of the Environmental Quality Incentives Program which was authorized as part of the 2002 farm bill.

Environmental research is a high priority. The last several farm bills have continued to emphasize the need for good research in a variety of areas all of which are important to agriculture. For the next farm bill we believe that we need to significantly increase the focus of our research efforts in the environmental area.

Federal Marketing Orders. We do not participate in the Federal Marketing Orders program. Because of this we do not take positions on proposals to reform or change Federal Milk Marketing orders. If you make changes to the Federal Marketing Order structure that would necessitate a change in our system, our system allows both producers and processors to request a hearing by the California Department of Food and Agriculture.

Within 60 days we could have a decision on whether a change would or would not be necessary to the California system. We may not always like the results but at least we have a system where we can get an answer in a relatively short period of time which would minimize any potential adverse effects that might be created by significant changes in the Federal Order System.

Mr. Chairman, thank you for the opportunity today and I would be happy to answer any questions and you have a copy of our text.

[The prepared statement of Mr. Cotta appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Cotta. I read your testimony on the plane out. We had plenty of time. I had plenty of time. It is a long flight. I didn't know how lucky I was that I could fly home in a matter of a few hours rather than have to fly to Phoenix and get here. I am very fortunate in that regard. Thank you.

Next we are going to go to Mr. Joaquin Contente, a dairy farmer and president of the California Farmers Union from Hanford, California. You have testified at least twice, I think, out in Washington so welcome again to this panel.

STATEMENT OF JOAQUIN CONTENTE, DAIRY PRODUCER AND PRESIDENT, CALIFORNIA FARMERS UNION, HANFORD, CA

Mr. CONTENTE. Thank you, Mr. Chairman. Also thank you to the rest of the distinguished panel that we have here today. I am very proud to have my fellow Portuguese people right here in front of me. It is quite an honor.

Today's presentation that I am going to present is going to be somewhat candid and I am not going to read anything. I am just going to go through and skim some of the stuff here. It is going to be from a producer perspective more than probably any other panelist here today.

Some of the challenges that are facing us as producers here in California and also across the United States is we are having rising imports constantly for the last several years that are impacting us, concentration in the marketplace, and we are seeing that today with our low milk prices that we have which leads to lack of competition.

I have a sheet that is towards the back of my presentation that shows the tremendous amount of volatility that we have experienced over the last 7, 8, 9 years that we did not have before previously. Forty years back we didn't have that volatility and that really impacts us as producers and it is hard to manage any type of bank structure with that kind of volatility.

Interestingly the California Milk Advisory Board has recently come up with a report on the State of the California dairy industry and I would encourage each and every one of you to get hold of that report and go through it. There are some pretty interesting facts that they have come to a conclusion on.

The main facts are basically that we have about a 4 percent annual production increase in California and they expect that to continue and only about a 2 percent market gain. How do we deal with that in the future for California? How do we come up with the capital necessary for plant expansion and so on? It is a very interesting report.

Producer prices, as someone has noted, are below the cost of production. It is about 30 percent below cost of production. The average 1,000 cow California dairy is losing anywhere between $50,000 and $70,000 a month. That is hard to sustain for very long periods of time.

CDFA has at the last hearing come up with some numbers that says that we are paying 16.4 cents per hundredweight in surcharges on feed and transportation. That is being added because of the increased input costs that we are facing on energy.

Back in 1996 Congress asked California to see if we wanted to join the Federal Order. At that time there was very little support from California to do that. Consequently, the Federal Order reformed itself to mimic California and adopt a California style make-allowance structure. In my mind that has been somewhat devastating for us as producers because we are basically now operating in a somewhat socialistic climate that guarantees plants those margins and us producers are basically at the whim of the market forces of capitalism.

Recently there was an article in the Cheese Reporter that stated the difference between the milk price in producers in California and another state which produces about the same make-up of class I and about the same production of cheese was Wisconsin. The milk price difference between those two regions, mailbox milk price difference, was $1.47 difference that we are getting less in California as producers.

One of the results of the style system that we have in California is that plants are decoupled from the market place. The signals that we receive as producers by low markets are not transitioned into the plants as they are to us. Yet, it is the plants that keep telling us that they need more milk and more production. How do we deal with that?

One of the solutions that, in fact, I testified to back in 2000 was by implementing a variable make-allowance. We can make that make-allowance structure actually work to be market oriented. When the market demanded products, the make-allowance would send a signal to the plant and encourage more production of those products.

Contrary when the market denied a good price for those products, then the make-allowance would also reflect that.

Trade policies. You would have to go back to 1993 Uruguay Round to look at what happened to dairy trade policies that were left out that probably should have been included. That would be the use of caseins in a structure such as the cheese, butter, and powder that we have on tariffs that would address those products coming in in the same manner and would have a tariff structure.

Casein has been left out completely. In my testimony I believe it's on page 4 we have a chart and in that chart it shows the milk equivalent of casein coming into the country for each year. It is the largest category. It is even larger than the cheese imports that are coming in. If you add MPC to that it is huge.

Yet, that is one area that we are totally neglecting. We have tried to implement some tariff legislations for those products but there is a lot of resistance by some of the industry. The other part of the casein issue is that the utilization of casein in products we feel are not equivalent to milk since the process actually eliminates most of the vitamin B6 and some of the calcium and other nutrients so we don't believe it is even the same product as milk.

Next I would like to refer to the last page that I have. It is a volatility and in that volatility chart if you notice the recent volatility you probably could go to 94, 95. We became a net deficit country around 1995. Part of the recent we have the volatility is because of that tightness of supply even though the market price today is dictating that we are not that tight.

I believe the current market price is a result of some extremely good spring weather that we had back in January and February here in California and across the country. We also had a lot of cows calving fresh in December and January that put on a lot of production. We had close to 6 percent increase at the beginning of the year. Those have all evaporated.

As those have evaporated, we are in a situation now where powder is tight. My co-op tells me that butter is tight. All the butter they have is committed. Yet, barrel cheese is also short and the market is not reflecting even though we had the tremendous heat wave in the third week in July which should have had a response to the market and it didn't even flinch.

On page 8 I have the retail spread difference showing the consumers what they are contributing to our cause and they are doing their part. It keeps going up but there is a huge spread between what the retail and the producers are receiving and that continues to get wider and wider. That is because of lack of market power by the producers.

The last two pages that I had put in there deal with the supply and the utilization numbers. There is a misconception in this country because most people think that we do produce more than we consume and it is not true. The people that do the work at ERS and we have talked to them recently just to make sure that we are on the right page and they have told us there is no utilization numbers that are brought in for the casein and MPC going into the marketplace.

Those are not figured in the utilization numbers. The papers that you have there would show at the bottom of the sheet for 2005 176 billion pounds of production. If you go to the far right of the sheet it would have 178 billion pounds of utilization. What they left out on the import side they only have 5.2 billion pounds of imports. If you throw in the utilization of casein and MPC, that number would increase significantly, perhaps double or even higher than double.

You can see that in this country we are quite short. If you go back before 1995 we didn't have that issue. I believe it is due to the policies that we have implemented from the 1980's forward on dairy policy that have actually got us to a point where now we have an unsustainable dairy industry in this country.

Solutions. The Milk Regulatory Equity Act, which the chairman actually helped bring that Act forward a few years back, would be one of them. The CME today is controlled by a very thin volume of product and also a very few people that are actually there. If you also look into the players that are in the futures market, that is also very thinly traded perhaps by the same people that are at the CME and so we need to have some reform there.

Back in California in the early 1990's we used to have a cost of production factor that we were able to implement for class I milk. This is just a thought and an idea but that is perhaps something we could look at where we could have some sort of a factor for cost of production along with the CME combined maybe perhaps with some sort of CPI for dairy as a combination to where you would take out some of the volatility. That is just a thought.

The last thing that I am going to mention is probably going to be somewhat controversial but increasing the support price to $12.50. Of course, we would like to see that done not through the Federal Government's efforts but as far as on the money side we would say that you could run a program somewhat similar to what we had back in the late 1980's when we had the Gramm-Rudman provision come in to where we were assessed a certain amount. If we did not exceed last year's production, we would have that assessment refunded back to us so it would be an incentive there to watch our supply site.

I hope that I have covered most of the issues that we have here before us and I would be glad to answer any questions. Thank you.

[The prepared statement of Mr. Contente appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Contente. Yes, you have covered them and your charts are very constructive. Thank you.

Next we are going to go to Dr. Sabino Herrera who is a dairy producer with Alhem Dairy Partnership and he also represents one of the cheese companies. I am sorry. Which one is it?

Dr. HERRERA. Hilmar Cheese.

Mr. GUTKNECHT. Hilmar. Welcome.

STATEMENT OF SABINO HERRERA, D.V.M., DAIRY PRODUCER, ALHEM FARM PARTNERSHIP, HILMAR, CA

Dr. HERRERA. Thank you. Good morning, Mr. Chairman, and members of the committee. Thank you for holding this important hearing today and welcome to the great State of California.

My name is Sabino Herrera and I am a veterinarian and dairy producer shipping our milk to Hilmar Cheese. I didn't grow up on a dairy farm. I grew up in the inner city of Los Angeles but learned the love of dairying and dairy medicine at the large scale operation in California's Central Valley.

I may have a different perspective than others on the panel, maybe even other dairymen as I am not a proponent of the so-called dairy safety net program. I am here today to convey to this committee just how important it is for us to revisit our current two-part dairy support program and for us to make meaningful and sensible reforms that are fair to all farmers.

As you already know, there are currently two subsidy programs in place, both with the goal of helping producers like myself. One is not very popular in States with large dairy operations like California, the Milk Income Loss Contract Program. The other program is the USDA's Dairy Price Support Program that has existed for decades andworks at cross purposes with MILC. But, together they lower milk prices and decrease dairy productivity.

Let me explain why MILC is so unpopular in this growing part of the dairy world. MILC is not a true safety net for all dairy farmers. Instead it encourages farmers to produce more milk because it keeps some farms in business that are not profitable on their own. At the same time, the price support program buys up whatever surplus cheese, butter and non-fat dry milk produced by these same farmers as another form of support.

And to make matters worse, USDA then has to find means to get rid of the surplus by reselling these dairy products or simply giving them away. This, in turn, significantly disrupts the marketplace, which affects all farmers. Even the USDA has said that the two programs are at odds with each other and decrease farmer income. This situation should not be allowed to continue.

Nearly $2 billion had been spent on MILC payments prior to the recent extension. That amount far exceeded the original estimates for the program. And truthfully, the money has only helped a limited group of farmers. One reason milk prices were so low for so long in 2002 and 2003 was because of MILC payments. These artificially low dairy prices were the direct result of a Federal system that failed to protect all farmers.

Committee members, I urge you to do away with the current system and start fresh with the creation of a single, sensible dairy program that achieves the purpose of providing dairy farmers with a safety net while protecting prices for consumers. This change is vital for the sustainability of many dairy farmers across the country and needs to happen sooner rather than later. I hope Congress can find the right vehicle to implement this overhaul.

Let me be clear on one thing. By advocating for a single system and not the current dual programs, I am not suggesting that dairy farmers need less financial help and funding. Rather, I believe that resources saved from the consolidation of the two existing programs can instead be used to support farmers in many other important areas. Dairy farmers are constantly struggling to keep up with the changing times and will continue to need help and resources dedicated to address new issues.

In the immediate future, dairy farmers, as a group, will have to concentrate on finding innovative ideas for sound environmental management practices and conservation. We also have to tackle the implementation of new technologies and meet the demands of creative promotion of our products. I did not know when I was young that I would be a vet and a dairy farmer.

I entered this business after a very positive experience at a well-run dairy farm operation. We need programs to help young people get into the business of agriculture. Dairy farming is hard work, but it is a business and we should not have to be dependent on Government programs to make our livelihood. What dairy farmers need is help dealing with real on-farm issues.

In the West, we struggle with water conservation and environmental compliance. Federal dollars could help us met these challenges, as well as help us become energy independent through the use of methane digesters. As a vet, I can tell you we could use more Federal dollars for Johnes disease research and eradication, and to guard against foot and mouth and mad cow diseases. What we don't need is to be tied down with the same unfair and costly support system that we have been saddled with for years while real on-farm needs go neglected.

I want to make sure you know I am not talking about giving us more and more money. We just need your help to make sure that Federal dollars are targeted at helping dairy farmers across the country. We certainly do not want money to go to new, hastily created programs like MILC or arcane, outmoded programs like the price support, but rather to programs that help grow our business.

Mr. Chairman and members of the committee, I am optimistic about my future and about the health of dairy in the Central Valley, but I am deeply concerned about the current dairy subsidy system. An overhaul of the dairy program in the next farm bill is essential for creating effective policy that will stabilize the dairy industry and enable us to continue to have healthy, high quality farms and produce dairy products that the public wants and enjoys.

I thank you again for holding this hearing here in California's Central Valley and I look forward to your questions.

[The prepared statement of Dr. Herrera appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you. Back where I come from veterinarians who work with large animals are called docs so thank you, Dr. Herrera, for your testimony.

Next we are going to go to Dino Giacomazzi who is a dairy producer with Western United Dairymen from Hanford, California. We welcome you. Thank you.

STATEMENT OF DINO GIACOMAZZI, DAIRY PRODUCER, WESTERN UNITED DAIRYMEN, HANFORD, CA

Mr. GIACOMAZZI. Thank you very much. I am an Italian dairy producer so I am a little south and to the east of Portugal but, you know, we all like good food and wine so we are not that far apart.

Good morning, Mr. Chairman Gutknecht and Mr. Nunes, Costa, and Cardoza. I want to thank you for holding this hearing today and hearing the issues of the dairy industry. I really appreciate that. My name is Dino Giacomazzi and my family has been milking cows and farming in Hanford, California since 1893. We currently milk 915 Holstein cows and farm 500 acres of forest crops.

My written testimony has a lot of details on farm bill issues and I wanted to narrow my talk today down to sort of a barometer reading of the current State of California dairy and talk about some issues that are farm bill related and some issues that are not farm bill related but are important to us as dairymen all the same.

The past 5 years have been quite a roller-coaster ride for the industry. We have had volatile milk prices, high energy cost, high feed cost, high animal replacement cost, high cost of doing business with taxes and workman's comp insurance, high cost of regulation and environmental compliance.

To quote my 93-year-old grandmother who was born on a dairy and lived on one her entire life, she said, "Never before have we had to do so much with so little." She recently said that and I kind of explained to her the situation with the industry. She has been around a long time and has very much seen it all.

On top of that, the past year has been filled with natural disasters including a heat wave costing the lives of more than 30,000 dairy animals and causing the dairymen close to half a billion dollars. That is just in the eight counties of the San Joaquin Valley.

Looking into the future we are confronted with two major issues, large scale environmental regulations and milk supply out pacing demand. To answer the question that was posed to us by Congressman Costa, as dairymen what we are really looking for is a handshake, not a handout. We want to keep more of our money to build our own safety nets. Let's reduce taxes.

Let's reduce the cost of Government. Lets change the structure of capital gains tax which in its current form promotes sort of artificial growth within the industry. We need to be able to ship money out of dairy for high value land into other types of industries. We need to shift away from the paradigm of it moves tax it, if it keeps moving regulate it, if it stops moving subsidize it. You all probably know who said that.

We milk 950 cows which may seem like a lot to dairies in the rest of the country but in my county we are actually below average size. With the environmental regulations that are coming down the pipe, it is projected that only 6 percent of all dairies are profitable enough to absorb the high cost of compliance. That means in order to survive the coming storm of regulation, your dairy would have to have more than 2,500 cows.

What this clearly indicates is that pretty soon California dairymen of all types will be knocking on the doors of Congress looking for help. As it happens in California, soon it will happen in the rest of the country. Following right behind us will be 75,000 dairymen from Wisconsin and dairymen from the great State of Minnesota as well.

Allowing us to continue to use check-off money for environmental research is a good way to help us help ourselves. Improving the way America views its dairy families has an impact on the demand for our products.

Here is another idea. Let's harmonize regulations, regulators, and reporting. We don't really need inspectors from the county, region, State, and Federal Governments coming to our dairy and measuring how much poop we have on site. There is no reason these agencies couldn't develop an MOU and share information, develop a standard reporting process that we can fill out and distribute to all the agencies. After all, we want clean air and clean water. That is our goal as well. Let's spend less money on regulatory bureaucracy and more money on technology to actually help the environment.

We appreciate and understand the need for a Federal price support system and I encourage Congress to keep the current system in place. I keep mentioning handouts today. I don't think the price support system is actually a handout. It is a safety net. In fact, it is the only farm program that I am aware of that actually pays for itself. It ultimately will pay itself back. It is a low-cost program. The MILC program is what I consider more of a handout.

This program does nothing to help increase the milk price. In fact, there is evidence suggesting that it actually slows price recovery. What we need is more and fair access to foreign markets with the ability to compete on the global stage. Rather than handout cash to dairy producers we would rather take that money to level the world playing field through the dairy export incentive program. There is money available for use today but it has been tragically under utilized. One thing you could do to help the dairy farmers right now is to see that the money gets spent. Let's use it.

Another great example of a no-cost program you could implement today that would have an immediate impact on the price of milk would be to increase the minimum non-fat solid standards of milk nationwide. Matching the California standards, for example, would not only contribute to a healthier American population but would also contribute to a healthier American pocketbook by reducing Government purchases of nonfat dry milk.

I took it out of my speech because I thought it would be too long but I feel it is important to say this. If we were to take and increase the standards of the Federal Government to what California is today, based on a 1993 study, and we produce a lot more milk today than we did in 1993, that would take a half a billion pounds of solids and put it into the consumers instead of into storage.

If you were to look at that in terms of how many loads of solids that is, that is almost 10,000 truck loads, semi-truck loads. If you consider that it would take an average of 8 hours to transport that powder from its origin to its destination, you would be looking at almost a million gallons of diesel just to transport that product. Here you have a no-cost program that would not only help the health of the country increase the price of the dairyman but it also would reduce our dependence on foreign oil.

It would help clean the air. It would improve our national security. Like I said, dairy producers are looking for a handshake. We are in a tight-knit partnership with our Government and need to utilize more self-help programs to promote a healthy industry.

It has been an honor to speak to you today. There is much more information on these topics and others in my written testimony and I invite any questions that you have at this time.

[The prepared statement of Mr. Giacomazzi appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you very much, Mr. Giacomazzi. I think you have offered a couple of very, very interesting suggestions and I hope my staff has written them down. I will try to remember them.

Mr. GUTKNECHT.

Next we have Mr. Leroy Ornellas who is a dairy producer from Tracy, California. Welcome, Leroy.

STATEMENT OF LEROY ORNELLAS, DAIRY PRODUCER, TRACY, CA

Mr. ORNELLAS. Thank you, Mr. Chairman. First of all, let me thank you for inviting me here, Mr. Chairman, and thank you for coming here to California for this hearing. Let me say that I am proud to be here in front of my Azorian cousins. I don't think any of us are mainlanders. We are all from Azores. Aren't we? There you go.

My name is Leroy Ornellas. I am a dairy farmer from Tracy, California. My wife, Jennie and our three sons, Kevin, Mark, and Mathew, operate two family dairy farms near Tracy. Our family milks a total of 650 cows and produce nearly 14 million pounds of milk over the most recent 12 months.

I am the third generation dairy farmer. Our sons are fourth our grandkids are the fifth on the same dairy. We originally came from the Hanford area. My dad as a young man and grandfather moved from their to Tracy in the 1930's so we have had a long history here in California.

Our family over the years has marketed milk to Carnation, Hilmar Cheese, and currently we market our milk Dairy Farmers of America. I am a member of Western United and I have the privilege to be San Joaquin County Board of Supervisors. In the Midwest a lot of times it is called county commissioners. That is a full-time job also so between that and the dairy business my days are full.

I appreciate the opportunity to testify at this hearing today. I have a written testimony document that is more detailed on all of the points that I will touch on today. I would like to submit that document for the committee's reference.

While organizations that I serve have not officially established positions for all of the 2007 farm bill issues, I would like to share my thoughts on some of the major themes that will define the dairy sections of the bill.

DFA members are participating with all the other members of the National Milk Producers Federation's Dairy Producer Conclaves to develop a consensus position on farm bill issues. We will keep you and your staffs informed of our efforts and seek your counsel on issues as we discuss them.

Because we do not think there will be radical shifts in policy direction as a result of the 2007 farm bill we support the view that an extension of the current farm bill which will work well for most of the Nations dairy farm families.

We feel the next farm bill should maintain some form of an economic safety net for dairy farmers. Safety nets prevent prices from falling so low that businesses become unviable. Past Congresses have maintained safety net provisions for the dairy industry. We hope this Congress will continue these policies. The most important safety net provision we have is the dairy price support program.

We favor continued operation of the dairy price support program at a targeted $9.90 U.S. average manufactured milk price. We would oppose granting the Secretary of Agriculture any discretion, which would reorient its intended purpose away from supporting income to farmers just to result in minimizing Government costs and we may need Congress to instruct the Secretary of Agriculture of this fact in some official manner.

Up until the last several months the CCC has purchased some NFDM doing what safety nets are supposed to do. The last time milk prices fell to safety net levels was in 2000 when the average class III price for the year was $9.74 below the safety net price of $9.80 for milk of 3.5 percent butterfat test.

The 10-year average class III price is $12.62. Because the price support program is in place and working we hope to avoid a price crash like in 2000 but if it wasn't around and prices did fall to that level, the Ornellas farm would face a loss in income of $402,439 on the most recent years production. It would be hard for our business to withstand.

We are very interested in stable policies that help to keep reasonable prices and a safety net that maintains some level of viability for a dairy farm family. Unfortunately not all of the Nation's dairy farmers have funded and are operating a self-help program, cooperatives working together.

Dairy farmers voluntarily pay 10 cents per hundredweight on all milk produced in order to structure the size of the Nation's dairy cow herd and more closely tailor milk supply to demand. Additionally, the program works to assist exports of dairy products in an attempt to market and promote domestically produced dairy products to the world.

Over the 3-year period of the CWT program, participating dairy farmers have contributed over $213 million, which to date was used to remove a total of nearly 3.2 billion pounds of milk from our domestic market. However, the CWT program is not intended to replace Federal farm programs and can never do so because there will always be those who choose to take advantage of the programs benefits but never pay their share.

Even after 2 years of successful implementation there are still over 25 percent of the country's dairy farms that choose not to pay in. In spite of our success we still need Congress's help in providing policy support to our industry.

I want to thank you Chairman Gutknecht for cosponsoring H.R. 4341 as part of a bipartisan effort to clarify that animal manure is not a hazardous waste under the Superfund law or its counterpart, the Community Right-to-Know Act. Congress should clarify that it never intended to jeopardize American agriculture by imposing strict, joint, several, and retroactive CERCLA liability on farmers for their traditional farming practices, including the use of manure as a beneficial fertilizer. I would ask you to urge your colleagues to support this important legislation.

In closing, Chairman Gutknecht, I want to thank you and the House Agriculture Committee, specifically your subcommittee, for having this field hearing. We know we can't explain all of our concerns here in detail but want to make you aware of them so that when we do provide you with additional details, you will better understand our concerns. I will be happy to answer any questions. Thank you.

[The prepared statement of Mr. Ornellas appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Ornellas

Let me start the questioning. I will try to keep my questions to the 5-minute rule. You all have been pretty good at keeping your testimony fairly compressed.

I would just ask all of you just as a general view, and we are not going to hold you to this, is there interest among California dairy producers in terms of becoming part of the Federal Milk Marketing Order System? What is your sense? We are not going to force you, I don't think.

Mr. COTTA. If you get more than one answer, there will be a difference of opinion I am sure. That is true anytime you have more than one dairyman in a room. From CDI's perspective at this juncture we are not interested in the Federal Order unless the Federal Order were to make changes that somewhat mimic some of the things we do here in California and that is allowing change in a relatively short period of time.

I would talk about the hearing that was held last January in the Federal Order System. The hearing was called Quickly so you could have a quick decision on Federal make-allowances. This is September. The hearing is being reconvened. Hopefully there will be an end to the hearing by January and who knows when you may get a decision.

John Block was the Secretary of Agriculture when there were some rules having to do with the amount of cheese on pizza and the amount of meat and that sort of thing. I think USDA is still sitting on that decision and that was 1980 so from that standpoint, it does not pique our interest to be in the Federal Order unless those kind of changes could be made.

Mr. CONTENTE. Mr. Chairman, our views are a little bit different than that. We look at the big picture and the big picture suggest that California's formulas continue to deteriorate the CME price because we always have either little transportation allowances or other gimmicks that come in.

If you look at the chart that I had on the comparison between California and the Federal Order prices, you will see as you move away from the year 2000 California has done a good job of having those hearings and adjusting those formulas. We just had one June 1 on whey. According to the Cornell study that just came out recently, the cost for whey across the country, I think there are 12 plants, and the weighted average was around 19 cents.

Yet, we just adjusted ours in California to 26.7 cents. Once you put in the rest of the formulas, 5.8 is the number of pounds in 100 pounds of milk times that difference. The 19 to 26.7 is about 7 cents times 6 so that is about 40 cents or, in our situation with the usage, about 20 cents on all milk difference that we have just taken away from producers.

You can see that the California system undermines the price at the CME because the CME eventually will pick up that lower mechanism that we have in there and it will ratchet itself down. It is not a very good system in my opinion. It be like a football game that has rules that California gets to have 11 players and the rest of the country only gets to have 9. We all need to be playing by the same rules in my opinion.

Dr. HERRERA. I agree with Mr. Cotta. We in California would like to understand what we are getting into and the Federal Order seems a little complicated. The expedient nature of California's dairy pricing and the quickness of how it responds to problems is a big factor versus the Federal.

Mr. GIACOMAZZI. Speaking for myself, I am sort of a libertarian by nature and anything that moves from local control to Federal control is something that I generally would be against. I think in the State here we appreciate the ability to have a reasonable amount of influence over our system and hopefully will get it to be more efficient than it is today but I think going Federal would magnitude the complexity. Multiply it by magnitudes I guess is what I mean.

Mr. GUTKNECHT. Thanks.

Mr. ORNELLAS. There are aspects of the Federal Order that I think all of us would support and admire. I think our California system allows us to petition the State much quicker than, say, the Federal Government and to get a response back even though it is not always favorable but we can get a response back quicker.

I don't think we would be in a rush to leave that system so I would say we currently like the system that we have. Speaking for myself, I think we are always open to new ideas, new thoughts, and we can keep discussing this as a possibility.

I did also want to add that my colleague mentioned about changing the standards in the United States and I support that wholeheartedly. That would just make a huge difference even though that is not the question you asked. Thank you.

Mr. GUTKNECHT. I just want to ask one more question and then I will turn it over to my colleagues. Mr. Contente, you talked a little bit about concentration and that is something that I worry about for a whole variety of reasons. I mean, the number of food companies that are out there is getting smaller and the companies are getting bigger.

You also mentioned MREC and I am also a little worried about that. In part because I am also a licensed and bonded auctioneer and I know you get better prices if you get five buyers than if you only have two buyers. I mean, that is generally the way it works. Although, if you have two good buyers, you can get pretty good prices at an auction.

What do you think we should do about that? I mean, that is a big question and maybe you can't answer it in the 30 seconds I have left on my time.

Mr. CONTENTE. Mr. Chairman, the antitrust laws that we have on the books if they had been followed over the last 25 years we wouldn't get to the position that we are at today so they haven't been followed. To turn that around and say that tomorrow we are going to enforce them all, that is not a reality either.

This is something that is going to take some time to resolve itself and I believe it is going to be a tough, tough battle. To give you an example, I ship to Land O' Lakes and we've got some cheese production facilities, three of them in California. We have a very large one just newly constructed a few years back.

At the end of the day less than 5 percent of the cheese coming out of these plants has a Land O' Lakes sticker on it. Somebody else's name is going to be on that product. My neighbor down the street he ships to Hilmar. Hilmar doesn't have their own label. They sell to other people. At the end of the day there is basically three major players in our industry.

You've got Dean Foods that has about 70 percent of the fluid in the metropolitan areas, the milk. And you've got my neighbor, Leprino, who has a large share of the food service, and Kraft has probably about 35 percent of the retail market. Those three guys basically control at the end of the day where our milk goes and they are the marketers.

Now, the almond industry in this State is huge. It has been growing leaps and bounds every year. It has been successful. In May I was at an Agriculture Day in Sacramento and I happened to ask one of the industry leaders there about the almond industry. I said, "How many buyers do you guys have in the almond industry?" He said, "Between 80, 90, to 100 independent buyers."

I think like you said yourself earlier, if you've got multiple buyers and sellers, you've got capitalism functioning. We don't have that in our industry. I don't believe that anyway.

Mr. GUTKNECHT. Thank you. I have taken more than my 5 minutes.

Mr. CARDOZA. Thank you, Mr. Chairman. I wanted to say something before I start asking questions. I wanted to give my colleague

Devin Nunes some big credit for pushing the bill that helped us maintain our California order in the cross-border shipment question. You did some great work there. A lot of you in the audience know about that work and I just want to applaud him personally in his hometown area for the work he did in that effort. It was really an important one.

Mr. COSTA. He spent over 2 years in that effort.

Mr. CARDOZA. A lot of blood on the House floor as well.

Mr. NUNES. I think you are being very kind, Mr. Cardoza, being that all of us played a large role in that including the chairman and, of course, Chairman Goodlatte. Thank you for your work.

Mr. CARDOZA. It is interesting as I listen to you all talk. Mr. Giacomazzi, you mentioned something that I think is really important, and that is the layers of the regulation that small, medium, large producers all have to deal with.

I want to tell a quick story because I think it is instructive for all of us who deal with Washington. When I was in the legislature I went back on a trip and met with the Clinton administration and suggested that the levels of over-lapping regulations, California's environmental rules, Federal environmental rules, how you have to meet all these different standards and deal with everything.

I suggested that the Federal Government should just say if the State of California meets the standards that they have set, that they should only have to meet the California standards and it would be certified as such. The Clinton administration fellow that I was meeting with at the time said, "Mr. Cardoza, we can't do that for a number of reasons." I said, "All right."

Then I went back 2 years later and had a different administration in the White House. I am thinking these Republicans they think Government shouldn't overlap so I am going to ask my same question. The Bush administration gentleman who I asked in the same room that we had met with the Clinton Administration 2 years before, same question, he goes, "Oh, Mr. Cardoza, we couldn't do that" for the same reason the Clinton administration gave.

What I am trying to say is it is not so much party but it is a matter of the question of mentality once we leave the State. It goes to your question also about which Marketing Order is better because when we lose the ability to affect our own climate and not be able to respond, I think that is a big problem for our local producers. It is a very tough thing. Until we can overcome that challenge, you are very smart in questioning getting involved in the national order in my mind.

The second thing I want to mention is you have a person in the room, A. J. Yates, who has dealt with both the Federal and State situations. As we go forward, Mr. Chairman, in discussing how we are going to deal with this, I would encourage you to consult with A. J. in the back of the room. He was assistant secretary in both the Federal and California. He served under both Republican and Democratic administrations as I recall. I just wanted to applaud and acknowledge the fact that you are here today, A. J., and thank you for your work in the industry over the years.

Finally, I want to ask a question of all of you and that is when we were dealing with the farm bill throughout the country, there are three areas that we are really focusing on in some ways other than the programs that you have already talked about. That is EQIP, marketing orders and research.

If you were going to prioritize those, how would you prioritize them and could you just briefly each speak on the importance of those three areas and how they affect your end operations and whether you are profitable or not and can even do business in the State of California.

Mr. Cotta.

Mr. COTTA. Well, I think you probably catch me a little short but I think we have got to protect our marketing orders because that is what gives the industry the ability to have some sort of system that you can manage that producers can deal with from coast to coast.

I think the other issue, EQIP with the new regulations coming down the pike on water, on air, and a host of other issues including energy production. EQIP needs to be high on the agenda and then research. You can't separate, at least I don't believe you can separate EQIP and research. You have got to know what happens before you can fund projects and you know what those end results are.

It is a dilemma we are operating under in California right now where we have had air regulations that have been put into place without proper research. When we get the research done then those air regulations are then amended. It could have been devastating to the industry a year ago if we had implemented what at least the San Joaquin Valley air control district was recommending for all large areas in the Valley, million dollar plus investments.

When we get the research back we find out that wouldn't have done anything for air anyway. I don't think you can separate the EQIP dollars available and the research necessary so that you can fund the right portion or the right system. Methane digesters may work for some. They don't work for everyone. They are not going to be the entire answer and you have little problems within the system.

PG&E will buy energy from a dairy at 3 cents a therm and they 12. Our attitude has always been, "Wait a minute. At 3 cents we lose money. At 6 cents we maybe break even. At 8 or 9 cents it probably makes the project worth doing." Until we find those areas and make those changes, it is very difficult for us to separate out which direction do we go or what do we tell our producers to do. We want them to make investments that indeed meet the criteria but you can't get there unless you have the right research that tells you what that criteria is.

Mr. CARDOZA. You brought up a great point and I want to get back to this. Mr. Chairman, I am sorry. I am probably going over my time but in the chairman's district there are State mandated certain energy requirements and that the energy they produce has to be able to go to the public benefit.

In California we have said that utilities don't have to take the alternative energy that we produce and that is why they are ahead of us instead of us being the pioneers that we could be in this field.

Mr. COTTA. We had a group of folks up 2 weeks ago at a methane cover lagoon system up in the Lodi area. Quite frankly, that system does work. However, the producer can double that but he won't because he has to sell it at a loss to the PG&E people. Those rules and regulations——

Mr. CARDOZA. When we had the California energy crisis and we were paying 28 or 40 cents we could have sure used some more digesters in the State to bring the cost down.

Mr. COTTA. You bet, but you can't build them for fun.

Mr. GUTKNECHT. Actually, this is one of my favorite subjects. I believe if you just give alternate energy sources access to market. I mean, the problem is the big oil companies control the distribution network for the gasoline supply and the power companies control the access to the market for electricity. Frankly, I am one who doesn't believe you really have to subsidize these things.

You just have to make sure that they have access to market so that is basically the strategy that we have deployed in Minnesota. Those who were at the hearing in Marshall I think got a chance to see that it is bearing some real fruit not only for farmers but I think in terms of having a more diverse energy portfolio so we are not totally dependent on one source for energy. I would be happy to give you as much time as you need on that one.

Mr. COTTA. I wish every member of the California legislature would go to Marshall, Minnesota and see what Jim and I and the rest of them there saw because it really would change the face of what we are doing here in California over night if they just went and visited.

I will get back to my original question very quickly. I know the chairman's is trying to keep us on time.

Mr. CARDOZA. Just to save time I would concur with Richard's comments on everything. The marketing orders is something we definitely need, especially with the concentration issues that we have.

Dr. HERRERA. I did research for about 6 years at UCLA and I know research doesn't take a year. It takes a long time. These regulations are jumping on these premature results of research. It is really sending us mixed signals about what we should be doing and what we need to do so I put research up on the list very highly and then EQIP funds below that because once that sound research is reliable, then we can do a lot with those EQIP funds.

Mr. GIACOMAZZI. You sort of opened a can of worms with me. I have quite a few opinions about this but I think Mr. Cotta said it almost perfectly about the problems with regulation and putting regulation before research. I think that is pretty common sense across the board. We really need to get away from these sort of shoot from the hip laws that are a reaction to lawsuits and what not and try to create a business climate that is more sensible.

In terms of EQIP we have to think of dairies—I think there is a tendency out there to consider dairies as this—well, I will put it this way. We tend to exclude the fact that we are also farmers when we talk about dairy. There is a lot of conservation efforts being done in farming in California right now that are mirroring some of the things that are happening in the Midwest through conservation tillage programs, for example.

Right now I am involved in an EQIP program where we are getting $30 per acre to try to reduce passes in the field. The solution we came up with was through strip tilling our corn crop we are able to reduce 80 percent of the passes that we make in the field just for that one crop saving diesel, saving emissions, saving particulate matter, reducing our cost of labor, reducing our ownership of equipment.

What it really boils down to is that environmental solutions don't necessarily have to cause you to sacrifice. There are environmental solutions that exist that are beneficial to the economy and beneficial to the environment at the same time. I think that environmentalists tend to believe that you have to suffer for the environment as is evidenced by our mitigation efforts for our air emissions regulation.

We came up with this huge suite of possibilities that dairymen could select to reduce BOCs and BFAa and particulate matter from their dairies. It essentially boiled down to a good dairyman, an efficient dairyman is doing most of these practices anyway. The enviros won't accept that. They want to keep suing it saying, "You know, if all they have to do is become more efficient to save the environment, that is not good enough."

I think that is something that has kind of burned up my backside because we really all have the same goals in mind. I believe EQIP funding for conservation tillage programs in California should continue, if not increase. I think there is a lot of data out there now that supports the conservation tillage programs.

Also with the cost of mitigating water quality issues like liners for lagoons and the need to track nutrients that are applied to the field through lagoon water we are going to require pipelines and meters and a lot of expensive high-tech equipment in addition to the reporting. I think EQIP plays an important role but obviously it all comes after. There are sound science to support the fact that what we are doing actually has an impact.

I have a whole other opinion about ethanol but I will save that for another day.

Mr. ORNELLAS. What was the third choice? I know EQIP and research. What was the third? I didn't hear the third choice.

Mr. CARDOZA. Marketing programs.

Mr. ORNELLAS. All right, marketing.

Mr. CARDOZA. Actually it was marketing programs but I was appreciative of the Marketing Order testimony as well.

Mr. ORNELLAS. Thank you. I am just going to touch a little bit on EQIP. For one thing, I think we need to streamline the process a little bit. I attempted to apply for the EQIP program on a couple of pieces of equipment and then just gave up on it it was so complicated. I think my colleague, Mr. Cotta, hit it. This is a very difficult State to do business. Extremely difficult. We do generally like our marketing system. We generally don't like our State government because of what it does.

You can put in a piece of equipment today and the laws change so rapidly that it is outmoded, outdated, inefficient, and no longer meets the requirements. There are constant requirements being changed. I know in county government we are seeing, for example, regulations in the State of California are changing so rapidly that a water system that is put in today is outmoded and perhaps illegal years down the road.

But the EQIP program I would say is a very important program for those who can take advantage of it and use it. Digesters, you have to be very cautious when you put half a million dollars worth of equipment on your dairy that may or may not work in a few years. For every digester that is in there are probably two or three that are no longer running. Anyway, I would probably right now put EQIP down. Thank you.

Mr. GUTKNECHT. Thank you. Mr. Cardoza. Mr. Costa.

Mr. COSTA. Thank you very much, Mr. Chairman. I have a question I would—a different question for each of the witnesses here.

First, Mr. Joaquin Contente, in your testimony I looked and you suggested that make-allowances could be altered to benefit both producers and processors. However, as I see it, with the variable make-allowance the producer and processor relationship represents both the supply and demand side of a free market equation.

How exactly would you propose that we change the variable make-allowance that would, in essence, benefit both the producer and the processor?

Mr. CONTENTE. You would establish the cost of production for milk as a zero point and that is already established. You would also establish the cost of production for a powder or butter or cheese plant and those numbers are out there. Those are the two zero points.

As supply moves, as the market moves, if the market starts to increase demanding more product, then the variable make-allowance would also increase to the plant. They would receive a higher make-allowance. Thereby producers are receiving the market price increase as a signal from the market. The plant would receive the make-allowance increase which would be related to the market so that would be tying the plant to the market.

Mr. COSTA. I think we ought to try to talk with our processor, for instance, to find out whether or not there is a basis there for a solution.

I would like to move on. Dr. Herrera, I agree with the chairman. Our veterinarian as the years I grew up on our farm, we had a dairy, kind of got stuck not only taking care of our large animals but also got stuck taking care of our dogs and cats and everything else we brought to him. They even did some home medication.

When we talk about the challenges with BSE and e-coli and other issues involving animal health and the concerns that today are in the public right now, of course, with the e-coli issue, I would like to get your take regarding animal health. As a veterinarian as well as a producer, what do you think is the largest animal health and food safety threat today to our milk supply?

Dr. HERRERA. Let's not just narrow it down to milk supplies. Broaden it up to agriculture in general. As we lose more and more farm ground here in the United States, I think we are going to have to resort to a third-world country growing our food and I think we are going to see more and more incidents like the one we are having right now with e-coli.

Mr. COSTA. So you are concerned about the balance of trade with regards to agricultural products? Is that the point you are making?

Dr. HERRERA. I guess my concern is our overall safety in the food industry and where we are getting our food from. If we can't grow it ourselves, we are going to have to resort to purchasing food from other countries. That is going to open up a whole——

Mr. COSTA. We already are. Last year for the first time in our Nation's history we imported more agricultural products on a cost basis than we exported.

Dr. HERRERA. Is that going to get any better?

Mr. COSTA. I think many of us on a bipartisan level as we are looking at the 2007 farm bill are very, very concerned that 10 years from now—and that is the question I ask myself, and I ask witnesses every time during these hearings, where do we want U.S. agriculture to be 10, 20 years from today?

Dr. HERRERA. Exactly.

Mr. COSTA. That ought to be what the bottom line is in my opinion.

Mr. Ornellas, you mentioned the need for greater funding for EQIP but talked about difficulties faced. As I said in the outset in my comments, the administration is going to suggest, and has already suggested, that the cost of the next farm bill be far below what the 2002 farm bill was even though experts agree that the 2002 farm bill was $14 to $17 billion below what was anticipated.

Of course, that is because commodities in many areas were better and, therefore, safety nets were not used but we know what the strategy was earlier this year with our negotiators with the WTO and the offers to slash a host of programs.

If you are sitting in our seats and you are, as you indicated, a locally elected official, what financial choices would you make in terms of cutting other areas of the farm bill to continue EQIP at its current level or market assess or others?

Mr. ORNELLAS. I have never used EQIP. I have attempted to.

Mr. COSTA. You told us it was too difficult.

Mr. ORNELLAS. So maybe it is not fair for me to say but I don't think the world would come to an end if the EQIP program was either cut back or——

Mr. COSTA. What would your priorities be in the farm bill?

Mr. ORNELLAS. To reduce?

Mr. COSTA. Well, to reduce, maintain, or to increase.

Mr. ORNELLAS. Well, I think a certain fair safety net for the dairy industry. I mentioned earlier about $9.90 as a support price.

Mr. COSTA. It is not clear. Did you support MILC? I was reading your testimony.

Mr. ORNELLAS. I did.

Mr. COSTA. You believe, unlike your other witnesses, that it must be maintained?

Mr. ORNELLAS. It is hard for me to imagine that a 60-cow dairy farmer in the Midwest that the program is going to keep them going for another year or two. It is just not that much. I know it helps and it helps us here in California. With the tremendous amount of losses that we have when we receive those checks that helps. We are talking about the MILC?

Mr. COSTA. Right. So you want to keep it?

Mr. ORNELLAS. Yes.

Mr. COSTA. All right.

Mr. ORNELLAS. I don't have a problem with it.

Mr. COSTA. Mr. Cotta, you spoke a great deal in your testimony about the trade policy. Some of us had the interesting experience Thursday morning to have three former Secretaries of Agriculture testify on their view on how we ought to write the 2007 farm bill. We had former Secretary of Agriculture Block, we had former Secretary of Agriculture Clayton Yeutter, and we had former Secretary of Agriculture Dan Glickman.

I asked the three of them, I said, "One of the complaints that my farmers, ranchers, and dairymen continually make to me is that they understand they have to compete on a global market. They understand that trade is a very vital, important part of our Nation's economy. Their constant complaint is that free trade doesn't translate into fair trade."

They all kind of deferred to former Secretary of Agriculture Clayton Yeutter who responded to me in very strong terms, as you might expect, that we had to reduce all trade barriers and tariffs, that we had to comply with the WTO. Obviously it was a different opinion than many of my agriculturalists reflect. I said, "You say that but you say the tools are in place for us to fairly compete." He said, "Yes. The tools are there."

Unfortunately, sometimes we don't use the tools properly." I would like to get your take as one of the largest co-ops of MILC not only in the State but in the Nation. You produce a whole lot every year. You try to export your product to the degree that you can. What tools is Mr. Yeutter making reference to that we are not using properly to have an ability to export our dairy products?

There is a graph here that I think Mr. Contente submitted that showed the gap between the amount of imported milk products that we do each year annually versus what we export. Unfortunately, the gap continues to grow. Is that your take on it?

Mr. COTTA. I think that is correct. I think if you look at the top of my testimony, page 3, we think there are three key areas, elimination of export subsidies, increases in market excess, and reduction in domestic support. I think those are probably the same areas that Secretary Yeutter was referring to.

Unfortunately, there seems to be very little ability for us to enforce those rules that are in place. Let me give you an example. A year ago we had 50 million pounds of powder committed to Mexico, specifically committed and made for Mexico, when they increased the tariffs by 30 percent as a retaliation for our tariffs on cement and steel.

I am not sure what cement and steel have to do with milk powder but the point is that is not in our business plan. We can live with the rules if you write them right but it is not in our business plan. We get notification yesterday. We also put in a multi-million dollar line to do milk powders with blends that we can export and that is a lot of the import problems we have coming into this country. They don't come in under dry milk powder or whatever.

They come in as blends so they are not really controlled. We have put in a multi-million dollar line to make blends and have been making blends and exporting them. Again, the Mexico situation comes up. We get notification yesterday that there will be a new tariff on blends but they think it will only last until October 31.

Interestingly enough, it seems to coincide with how much milk is available in Mexico at the time.

Even though they used the steel and the cement argument, at that point there was a little more milk in Mexico than they needed and they wanted to cut back on exports so that was the deal. If you look right now there is a little more milk in Mexico than what they need. I just find it incredible that we would again be informed that we have this new set of tariffs put on product we currently have in inventory, but it looks like it will expire on October 31 which kind of looks like when they will probably be about out of powdered milk product there.

I mention Mexico because that is close but that goes on all the time. We do export a lot of butter. Powder goes to about 40 countries of the world. Until someone enforces the rules for everyone the same, we are really spinning our wheels and our business plan doesn't account for spinning wheels.

Mr. COSTA. Obviously that is something that goes beyond the subject of the reauthorization of the 2007 farm bill. I think it is something that this subcommittee and, frankly, that the House Agriculture Committee needs to focus on as we talk about trade. Trade is such an increasingly greater part of how American agriculture ultimately is going to succeed or not succeed, in my opinion, over the next 10 to 20 years. I just think that the playing field, as we like to use the terminology, is not being evenly dealt with.

Mr. COTTA. You are correct.

Mr. COSTA. Until this administration or any future administration, and that criticism I could level for the previous administration, I like to tell my farmers too often it is the tail wagging the dog. Our foreign policy ends up dictating the effects of what our agricultural policy will be. We understand the need to maintain our foreign policy.

Nonetheless, it is a difficult way to treat American agriculture, I believe. Until we get serious about it being evenhanded with our trade policy as it relates to agriculture, I think we are going to continue to have this problem regardless what administration we are talking about. It is something we need to do a better job of.

My final question would go to Mr. Giacomazzi. It is not really kind of part of the hearing here today but I know you deal with it. Last month I was in a hearing that we had here in the district on immigration. As you know, it has been a very important focused issue. It has been a contentious issue in Washington in the last year and a half.

I want to get your take because when they talk about agriculture, notwithstanding the fact that agriculture employs I know less than 20 percent. I heard the numbers 16 and 17 percent of the illegal workforce that is here in America today. Too often when they talk about agriculture it is viewed as seasonal harvest work.

I would like to get your take on whether or not you from a dairy perspective, because we all know dairies operate 365 days a year. Those cows have got to be milked at least twice a day and some dairies do it three times a day. You are talking about a permanent workforce. Do you believe that we in Washington need to be focused on comprehensive immigration reform, Mr. Giacomazzi?

Mr. GIACOMAZZI. I guess the answer to the question is yes, I do believe you need to work on comprehensive reform. I don't support the hiring of illegal immigrants. I believe that anybody who is willing to work should have the ability and shouldn't have to go through such a complicated process to come to this country and get a job and pay their taxes and try to achieve the American dream which all of our ancestors came here and obviously did achieve.

I will relay a personal story that really expresses my opinion about this issue. I have an employee who was one of my best guys. He came to us about 10 years ago and he didn't speak a word of English. He was fresh off the boat, I guess, they used to call the Italians.

Mr. COSTA. FOB.

Mr. GIACOMAZZI. FOB and WOP, too. I am not sure if he was WOP or not but he had started out milking cows kind of at an entry-level job and eventually moved. They kept moving him up because he was such a great guy to the degree where he was practically managing the farming operation. He spoke great English and was really integrated into the company. We tried to provide for him and his family as much as we possibly could.

Well, 2 weeks ago he came to me and said, "I have an opportunity to go work for a cheese plant in Tulare for almost three times what you pay me. They are providing me and my entire family health insurance and a retirement plan." I said, "I understand that you have to do what is best for your family. I am sad to see you go."

The result of this is that is essentially the trend. In a permanent business we take people relatively unskilled and we bring them into the system. We train them up to become skilled labor and then they move up and out of the industry. I believe it is necessary for us to have a supply of people who are willing to do the entry-level jobs, not just the management jobs.

Also we are in a difficult position because I personally don't believe that the agriculture universities in California are doing an adequate job of training managers that could come out of the university and go directly to a large-scale dairy operation and work in a management role. We are really faced with growing people up through the ranks starting them out entry level positions and bringing them up so comprehensive reform, yes.

Mr. COSTA. I think you made the point. The fact is that not all agriculture jobs are seasonal. Many of them are year-round and with under 5 percent unemployment in this country and you take away those who can't work or won't work, in many areas we have tremendous shortages of employees and we need to address this issue. Thank you very much.

Thank you, Mr. Chairman.

Mr. GUTKNECHT. Thank you, Mr. Costa.

Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. I want to talk a little bit about milk protein concentrate and the imports that have continued to come in to this country because I think it has a huge impact on milk price. All of you mentioned in some form or fashion the impacts of trade, our trade policy on our milk markets.

I want to talk about some of the solutions. I want to start off with the assumption that we are not going to be able to change our trade policy. I know a lot of you here want to change our trade policy in terms of putting import quotas and tariffs on imports.

In the past I have supported that and I still do because I think that in 1993 we did not know what was going to happen in terms of new technology that would be developed so that instead of a certain form of milk powder they would change it a little bit similar to what Mr. Cotta called a blend. Pretty soon some people estimate it could be as much as 10 percent of our milk supply is actually foreign milk.

With that I think I will leave that question open to all of you making the assumption that we can't change the trade policy. What can we do to compete worldwide and why don't we just start off with Mr. Cotta and work down the line.

Mr. COTTA. Well, when you say you can't change trade policy, I am assuming that you can't enforce current policy and that doesn't require a change. That being the case, then we need to take a look at milk protein concentrates or caseins. They were obviously overlooked initially when the tariff proposals were put on the table.

I think we need to reexamine that issue. There are a lot of other areas where milk comes into this country. Chocolate block is a good example. Comes in and doesn't count as a milk substitute but, nonetheless, as you know, milk chocolate is primarily milk. I think those areas will certainly need to be looked at.

The other is we can either make up our mind to continue outsourcing MPCs, which is not a good idea for the U.S. dairy industry, or we can look at developing our own domestic system. We have been in favor of developing a domestic system and by using some sort of temporary processing subsidies, we think under WTO. If you develop a system to be used directly in your country, that would be a legal scheme under WTO. For export we could use it to build a system in this country.

Mr. NUNES. Mr. Cotta, I know one of the misnomers out there is that New Zealand and Australia are not subsidized in terms of their dairy industry. But, in fact, and I think you may have a couple of examples of this that you have shared in the past with me, they have subsidized their milk protein concentrate business. Could you talk a little bit about how they have been able to do that?

Mr. COTTA. Understanding that we are in a partnership agreement with the New Zealand people right now, it makes it difficult to speak about our partners. Certainly they have done some things there. They have a national trading enterprise we think that violates some WTO regulations. We think, yes, they do some things that are very interesting, particularly in New Zealand whereby they take certain components out of milk, microcomponents that are very valuable, remove those, sell them on the market.

Lactoferrin is a good example. Put the milk stream back together and dry it as either milk protein concentrate or nonfat dry milk powder. That we are not allowed to do in this country. It gives us a disadvantage right off the get-go. Certainly those are the types of things we need to look at. I believe your committee and working with the industry needs to look at and we need to get by those kind of barriers that currently get to us.

Mr. NUNES. Thank you. Mr. Contente.

Mr. CONTENTE. Congressman Nunes, this is an issue that I have been working on for several years and have studied extensively. I think we've got to be honest with ourselves and ask the question why is the usage of MPC increased over the last several years?

One I alluded to earlier was that this country no longer has the ability to produce the milk that it needs so, therefore, it has to rely on some imports. Second, the EU has a scheme that it pays the plants a subsidy to convert powder into casein and then the plants can sell that. And it will fluctuate depending on their supply of extra milk, residual milk, and also currency.

There is a relationship with currency. It has been up to as high as 40 percent of the value of that product. So then you can see that to a processor in this country there is a no-brainer. Let's get some of that cheap protein and let's put it in our vats and we can increase our yields.

The second part I think we've got to look at is regulatory function of our Government. FDA up until now has not bought into the fact that it is a legal ingredient to use in cheese processing in standardize cheeses which is most of the cheeses that you will find in the grocery store shelf. Why would we want to go down and pursue something that is of less quality, less nutrition. We have invested over $5 to $6 billion over the last 20 years in our checkoff programs to promote the wholesomeness and goodness of dairy products. Why would we want to pursue an avenue that takes us down a cheap alley? I think that would be a blow to dairy producers.

Mr. NUNES. Thank you. Dr. Herrera.

Dr. HERRERA. Great question. Without halting the income of milk protein concentrates the only way to get rid of ours is to move it. As Mr. Contente mentioned earlier, the McKenzie study showed clearly that we really need in this industry the investment and innovation and the use of our products in a variety of new things. I think the mobilization and utilization of these products and innovative products is going to be the key to utilization without halting imports.

Mr. NUNES. Thank you, Dr. Herrera.

Mr. Giacomazzi.

Mr. GIACOMAZZI. I understand the part of the concern over trade policy has to do with WTO regulations or what may or may not be legal within WTO but I think there has been some creative programs within other countries that tend to work around WTO regulations. For example, in Switzerland they have moved a lot of their direct payments for commodity crops to conservation payments.

Rather than paying the farmer directly for the crop, they are paying them to implement environmental practices or to conserve. Therefore, they are getting around WTO issues with these green payments. I believe that some form of subsidized plant construction in the country is what it is going to take to displace imported MPC to give us the ability to compete with outside product. I can't say how that would work. Maybe there is some way to integrate the MPC plants into an environmental program.

Mr. NUNES. Incubate, not subsidize.

Mr. GIACOMAZZI. That's right.

Mr. NUNES. We don't like that word.

Mr. GIACOMAZZI. Well, look at the U.S. ethanol market. How are we improving the price of the corn market for the corn farmers? We are building the ethanol plants and giving them some place for the corn to go. We could do something modeled on that for the dairy industry.

Mr. NUNES. Thank you, Mr. Giacomazzi.

Mr. ORNELLAS. Thirty or 40 years ago our industry prided itself in providing product for this country and not chasing foreign markets. I realize the world has gotten smaller so now we are more in a global world and global marketing and such. I still think our priority ought to be domestic markets.

I think we have to be very concerned as we continue to expand our industry whether it is the producer or the processor to chase foreign markets. I think we are asking for trouble. I think our priority ought to be to fill our needs here first and then when we are into an excess amount that we can then perhaps choose to go after other markets.

I realize having said that if we are then short, then it opens the flood gates for foreign products in here. I think one of the problems that U.S. agriculture has, I believe 25 percent of all the corn, soybean, other type crops that are grown are grown for export. We have never had that problem in the United States with our dairy industry because we tailor ourselves for this Nation.

As we begin to look, and I hear in testimony about expanded markets, other countries. We should be a little concerned about that, that we are not building to fill those other markets because I don't know that we could compete with others. I can compete with my neighbors. I can't compete with other countries. Thank you.

Mr. NUNES. Thank you, Mr. Ornellas.

I think my time is up, Mr. Chairman, so I yield back.

Mr. GUTKNECHT. I want to thank you and I want to thank this panel. Let me just for the record say that one half of the soybeans grown in my congressional district, and I think depending on the year we grow more soybeans in my district than any other congressional district. We are No. 1 or 2 every year. Half of the soybeans that are grown in my district ultimately wind up in export markets. It is an interesting concept that we really haven't started to explore in terms of potential export markets for dairy products.

I want to thank all of you for coming and we will allow you folks to leave the panel and we will bring up our next round. Thank you very much.

In the interest of time I am going to go ahead and start with the next panel. Our first panelist is Mr. Jeep Dolan who is the vice president of operations for Driftwood Dairy from El Monte, California.

Welcome, Mr. Dolan. We want to thank and welcome your son, Shane, as well for coming up to join the hearing today.

STATEMENT OF JEEP DOLAN, VICE PRESIDENT, OPERATIONS, DRIFTWOOD DAIRY, EL MONTE, CA

Mr. DOLAN. Thank you very much. Thank you very much, Mr. Chairman, and the other members also. Mr. Chairman and members of the committee, I want to thank you for the opportunity to testify. My name is Jeep Dolan, again. Like you said, I am vice president and co-owner of Driftwood Dairy. We are a regional creamery. At one time we did have dairy cows and operated dairy farms but now we are an entire creamery operation.

I wanted to talk a little bit about how some of the dairy policy relates to smaller individually private and family-owned businesses. Driftwood Dairy has been in the business, like I said, both dairy and creamery since the early part of last century. My great grandfather ran a dairy in Los Angeles through the 1920's and 1930's and later moved to El Monte. In 1946 my uncle picked up where he left off at Driftwood Dairy and that is where we remain today located in El Monte about 12 miles to the east of Los Angeles.

Primarily 70 percent of our business is in food service and copacking products for other dairy processors. Driftwood is probably the No. 1 or 2 school supplier of milk to school food service throughout the country. We have 95 school districts from Camp Pendleton all the way up to the Santa Clarita Valley.

We may be considered a small player on the industry stage. Our presence in local communities in the State is large. Our industry is a critical link to the farm to table economy that ultimately supports dairy producers. We are focused to operate under some Federal policy constraints, however, that prevent us being more efficient in our role as linking product to consumer.

Let me discuss a few of the concerns here today. Congress needs to ensure there is a level playing field so everyone can compete fairly whether they are a large national company, small creamery, co-op, cheese plant, Congress needs to ensure that the Federal regulatory system is more responsive to industry changes. We feel they need to review and phase out ineffective marketing and distorting dairy price support programs. We need help to assist the industry to help guard the dairy's franchise and wholesomeness and nutrition through the pure dairy foods that we manufacture here in the United States.

Again I would like to thank the members of the committee for helping level the playing field by passing the Milk Regulatory Equity Act. We operate in the Southern California State Order and Arizona Federal Marketing Order, FMO. so we have had firsthand experience with the problems created by the uneven playing field. Whether you are big or small, co-op, or processor, there shouldn't be any preferential treatment, especially when it impacts marketplaces in a negative fashion.

Also, the other concern of ours was the almost 2-year time frame that it took to resolve the issue. It kind of indicates the time that the Federal Government in their agricultural policies have as it relates to rectifying problems and fixing problems in a timely fashion which we do have available here in California.

We have been able to correct market conditions numerous times in the time it takes the Federal Government to act on one issue.

The processors and farms are fundamentally business operations and really should be treated as such. This committee really strives to be fair to everyone in the industry and not just think good policy can result from a particular region or particular group over another.

Also, Congress needs to ensure that the Federal Regulatory System is more responsive to industry change. If Congress should decide that the Federal Milk Marketing Order should continue to regulate price, then the system needs to function in a manner that allows the market to operate. I do not believe Congress should have to step in and fix every problem. USDA and the Marketing Order regulators should be able to do it but they need to act in a timely fashion.

The producer-handler issue is a good example. It took USDA years to resolve the problem like I mentioned earlier.

Third, Congress needs to look at the old subsidy program, the Dairy Price Support Program, and phase it out. The concept of an economic safety net for producers is a sound and appropriate goal for Federal dairy. The current price support program is creating distortions in commerce.

We used to be a commodity processor and produced commodity products, primarily nonfat dry milk, in the 1980's and we saw first-hand the problem and unintended consequences of the give-away and allocation programs of nonfat powder ultimately from USDA to the States to the schools and then they would forward the product to us for process.

What happened in that program is that we would receive dry milk powder that was over a year old on the floor of trucks. In today's environment with HACCP and GMPs we could no longer receive that type of product and it is not fit for a grade A product that goes into school milk.

We can't continue a program that creates a secondary market for dairy products that may foster cutting corners to make a dollar. The image of the dairy industry is one dedicated to quality and meeting consumer demands is just too important for our industry.

Cynics might ask, "Why would processors care about the Government buying up the surplus milk powder?" The answer is simple; we are in the business of being the link between dairy farmers and 90 percent of all consumer households in America. Government does not operate well in this free enterprise.

However, this is exactly what is happening with the dairy price support programs and it is not working. There has got to be a better way to support all dairy farmers equitably without having the Government attempt to stabilize prices by purchasing surplus dairy products.

Lastly, instead of price controls strict regulations, Government intervention in the marketplace, and expensive subsidies Congress needs to help the industry guard dairy's franchise in wholesomeness and nutrition. Dairy is one of the most nutritious and beneficial foods in the marketplace.

You might not believe it but we are under increasing competition with soda companies and other beverage companies. What you reach for when you are thirsty may be a dairy related beverage but it may be an unregulated dairy beverage. We are so strictly regulated as it relates to our ingredients and prices it frustrates our ability to compete with these other soda and beverage companies that are not subject to the myriad of regulations that we are.

The issue of a level playing field should apply here, too.

As I mentioned when I started, we are a leading supplier to school food service programs in the country. Therefore, what happens to us on the milk and agriculture front ultimately affects our ability to provide school children with stable pricing for milk, juice, and other dairy related products.

We are a small processor in a big industry. Congress has an obligation to help businesses like ours and the big dairy companies as well and co-ops. My family has been involved in the dairy for four generations, long before Driftwood was around, and I am dedicated to making it profitable and successful for future generations of our family.

We see a myriad of opportunities to grow and prosper but we need your help to level the playing field and break down some of the old bureaucracy that is standing in our way. We cannot be hamstrung with old regulations or a view of the industry that does not comport with the realities of today's marketplace.

Mr. Chairman and members of the committee, thank you for the opportunity to testify.

[The prepared statement of Mr. Dolan appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Dolan. If I have a chance, we will come back to that point you made about competing against the soft drink industry because they are incredibly competitive and they understand marketing and advertising. We are a little slow to really be able to compete with those guys.

Next we have Ms. Sue Taylor who represents a little company called Leprino Foods. I think they are in the mozzarella business but we will hear more about that.

Welcome.

STATEMENT OF SUE TAYLOR, VICE PRESIDENT, DAIRY POLICY AND PROCUREMENT, LEPRINO FOODS COMPANY, DENVER, CO

Ms. TAYLOR. Yes, we are. Thank you very much, Mr. Chairman. Mr. Chairman and members of the committee, thank you for the opportunity to appear before you today. My name is Sue Taylor and I am vice president of dairy policy and procurement at Leprino Foods.

Leprino Foods is a family-owned company that has grown from making small batches of ricotta and mozzarella cheese for local delivery to the world's largest producer of mozzarella cheese. We operate nine plants in the United States, manufacturing mozzarella cheese and whey products. Six of the 9 plants receive milk pooled in the Federal Milk Marketing Orders. We operate three manufacturingfacilities that are regulated under the California State order.

Before discussing issues related to the next farm bill, I would like to thank members of the committee for passing the Milk Regulatory Equity Act earlier this year. It was a critical piece of legislation and we appreciate your efforts.

In an effort to prepare the dairy industry for future competitiveness here and abroad as part of the next farm bill, we suggest Congress mandate that USDA act with speed in its regulation of the Federal Milk Marketing Orders to keep up with changes in the dairy marketplace; give all producers and processors risk management tools like forward contracting; and resolve the conflicting nature of the two existing Federal dairy safety nets.

First, I want to thank the chairman for his support of updating the make-allowance to allow the milk pricing formulas of the Federal milk marketing order to reflect current manufacturing costs. I have just returned from the USDA hearing on the make-allowance and I hope the Department will act quickly on the hearing record and finalize the formula update within weeks and not months.

The delay and politization of the make-allowance update is of great concern to Leprino and other dairy manufacturers across the country. The make allowances in the current formula are based upon cost data from the late 1990's. With the significant rise in energy, healthcare and other costs since the late nineties, the industry was closing in on a financial crisis by 2005.

Going to the marketplace to recover the increased costs is not an option. The make-allowance hearing was requested and granted on an "emergency" basis last year. A 4-day hearing was held last January and yet, here we sit with no decision from USDA some 9 months later. A year of deliberation is simply not acceptable when the industry is losing millions of dollars a month.

Mr. Chairman, I hope you will continue to urge USDA to finish what they started and not be distracted by calls to link this simple, straightforward exercise with other proposals that are unrelated to the pricing of milk for manufacturing.

Congress should urge USDA to take a page from the playbook here in California. The California State milk marketing order also has hard and fast deadlines for considering and making changes to its State order. Changes are implemented within 60 days after concluding its public hearing, as required by law. This system has allowed California processors and producers to be more responsive to commercial demands while the rest of the Nation lingers under the cumbersome bureaucracy of USDA.

Price volatility has become an increasing concern to domestic and international customers alike. I believe that the ability to forward price significant volumes of product is key to driving demand for American dairy products. Unfortunately, multiple food service customers have told me that they are frustrated by price volatility over the years and, as a consequence, are minimizing the use of cheese in menu items. Neither producers nor processors win when our ultimate consumers turn away from our product because of volatile prices.

Leprino routinely uses the risk management tools available to offer forward prices to our customers, but futures market liquidity on the Chicago Mercantile Exchange where dairy is traded still makes accumulation of significant volumes cumbersome. Congress can help address this need by reinstating the dairy forward contracting program.

In addition to the demand issues that will be addressed by forward contracting, I can tell you as a former agricultural banker with continued ties to that community, forward contracting is an important tool in the producer arsenal.

Reforming Current Federal Safety Nets. Finally, I would like to briefly comment on the current Federal safety nets. Leprino is very concerned that the Milk Income Loss Contract Program impedes the industry's transition to becoming a more competitive long-term player. The program's current structure with a very high target price and limitations on eligible production shields smaller producers from market forces, resulting in greater production and loweroverall market prices.

At the same time, mid-sized and larger producers are primarily gaining their revenue from the depressed markets, placing these more efficient producers that represent the future of our industry under financial stress. The MILC program runs headlong against the U.S. industry's need to become more competitive.

Moreover, the current dairy price support program is not operating as intended. The dairy price support program has also become more disruptive to the marketplace. For example, the accumulation of over a billion pounds of nonfat in USDA's coffers a few years back was very disruptive. Given limitations on distributions for international food aid, USDA started giving away surplus milk powder accumulated through the dairy price support program for livestock feed in drought areas.

The more powder that came out of Government storage, the more prices in the free enterprise whey market were undermined. Leprino's whey and cheese business is hurt when the Government is buying product and dumping it on the marketplace when it is not needed.

I would like to add a comment to my written testimony on the concept of the development of a milk protein concentrate subsidy program that was explored earlier in this hearing with the producer panel. The committee should not adopt more market distorting subsidy programs in the farm bill. The height of concern on milk protein concentrate imports came at a time when world market prices were significantly below domestic markets encouraging importation.

Additionally, milk domestic production of MPC was available. Since that time progress in trade reforms have continued to increase international market prices due in part to reforms implemented through the Uruguay Round of the WTO and partially due to the EU budget constraints along with growth and worldwide demand.

Additionally, a domestic milk protein concentrate production industry is developing to satisfy the domestic demand. The milk protein concentrate processing industry is growing in response to market signals and should be allowed to continue to do so.

Leprino is operating under the laws of supply and demand but the current dairy programs with these two conflicting safety nets are not. The price support program and the MILC program work against one another and stifle innovation and growth in the dairy industry.

In conclusion, today in dairy we have a Federal pricing scheme that is complex and unresponsive to markets. We have to deal with greater volatility and production of unwanted, surplus products. This web of programs combines to put the U.S. dairy industry farther behind our competition.

However, with your help in modernizing these dairy policies, we will have a greater opportunity to expand domestically and earn a greater share of international markets. We need Federal dairy policies that help pave the way, rather than impede our progress to flourish in the long-term. Thank you.

[The prepared statement of Ms. Taylor appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Ms. Taylor.

Next we are going to hear from John Jeter who is the president and CEO of Hilmar Cheese Company in Hilmar, California. Welcome

STATEMENT OF JOHN JETER, PRESIDENT AND CEO, HILMAR CHEESE COMPANY, HILMAR, CA

Mr. JETER. Thank you, Mr. Chairman, and members of the committee. My name is John Jeter and I am CEO of Hilmar Cheese Company. Hilmar is a unique company. We are a producer owned, private company and really a hybrid in the industry in the sense that we are producer owned, yet we are not a co-op.

We currently buy over 10 percent of all the milk in California. We are now in the process of building a new plant, a cheese processing plant in Dalhart, Texas. This new cheese and why protein processing plant in Texas will be the company's first processing plant outside of its Hilmar, California facility and corporate headquarters.

We were founded to increase the prices producers receive for their milk, and we have been very successful, despite Federal regulations and programs that were originallyintended to help producers but actually stand in the way and handicap the whole of the U.S. dairy industry.

The next farm bill provides Congress with a tremendous opportunity to bring more cohesion to our fractured dairy programs and to recognize and rectify the unintended consequences of the well-intentioned but flawed programs in place today.

Let me start by offering one example of such a well-intended program that is actually retarding natural growth and progress in the industry: the Milk Income Loss Contract program otherwise known as MILC. It is symptomatic of Federal dairy policy today and I am sure the committee has heard differing opinions on the program. I am here to report that I believe the program is counterproductive, expensive, and it is unnecessary.

The MILC program is counterproductive because it works at odds with the dairy price support program. The price support program was once intended to clear the market of excess production, but now it simply stimulates excess production and keeps prices low. The MILC payment compounds the market distortions by subsidizing the excessproduction and further lowering overall price levels, which is detrimental to all in dairy. These two programs are simply incompatible.

USDA's 2004 analyses of the programs confirm this determination. USDA's Deputy Chief Economist Dr. Joe Glauber explained it this way at a recent Senate hearing on dairy policy. He said the MILC programs works "at cross purposes with the underlying market price support program if you're creating incentives to produce more milk, well then that can potentially cause a price decline."

He explained when this happens, "The Government steps in and purchases product." He went on to testify the current system creates, "stock piles that end up growing quite large", "potential product imbalance" and distortion in the markets. This is all from USDA.

On top of all this, the MILC program is also expensive. It was meant to be a temporary assistance payment to dairymen; a transition program from the failed Northeast Dairy Compact, conceived in 2002 during the farm bill debate, but by the time it was implemented it was extended retroactively to 2001.

Based on its March 2004 estimate, the Congressional Budget Office projected that the cumulative cost of the MILC program over its expected 4-year life was going to be approximately $3.8 billion. This is significantly higher than estimates offered in 2002 during the farm bill debate, when the CBO estimated total direct payments of only $963 million over the life of the program.

MILC was supposed to sunset in October 2005, but Congress extended this program through 2007. Ironically, it was the budget savings bill, the measure to cut Federalspending, which extended MILC at a cost of another $1 billion, at least.

MILC is unnecessary and counterproductive. There exists another program designed to prop up farm gate prices of milk, the Federal dairy price support program. In the next farm bill, we need to resolve which of these programs, if any, to keep and which to get rid of. Neither are ultimately truly helping producers, processors, or consumers. In fact, by the time the MILC payments kick-in, after the price support program, taxpayers have paid for the same milk twice.

While as I said at the outset, Hilmar is dedicated to delivering better prices to dairy producers, we do that through adding value to their milk and supplying the market with what consumers want. That is how Hilmar is different, we do not expect the Government to help us meet expenses or guarantee a profit. That is not a formula for success in our free enterprise system.

Our focus is on making world class cheese and value-added whey products, so to me the current two programs we have now in dairy do not make sense. Why are we paying producers to make a product, i.e. non-fat dry milk, that is not being demanded by the marketplace but that has the best return when it is sold to USDA to be stored in awarehouse?

The Dairy Price Support Program may be guaranteeing a price to producers, but it is not adding value to their milk, nor is it serving consumers who ultimately determine the value of milk and dairy products. What the Dairy Price Support Program does accomplish is to stand in the way of innovation in products and in the way of investment in technology and is probably is one of the main reasons that we have not grown our MPC markets or produced that domestically.

Fundamentally, what Federal dairy policy does today is ignore the law of supply and demand. It focuses in on getting more money to the producer that in most cases means more production. A critical missing point in our policy discussions is: where will this milk go?

In the next farm bill I would urge you ask a simple question. Is it really sustainable to subsidize production with the MILC program and then take that milk off the market through the dairy price support program and keep it in Government warehouses? As far as I can tell, the "demand" for non-fat dry milk by Federal warehouses is probably pretty limited. Obviously our view is that both those programs depress producer prices.

On the other hand, the demand from the market for cheese, new and innovative consumer demanded, value-added dairy products, domestically and globally has barely been tapped in any real and significant way. In addition to U.S. consumer demand for new, interesting and quality products, there is a demand for specialty protein products from foodmanufacturers and there is a growing export demand.

Consider this: the U.S. exported percent of its production last year a big increase from a few years ago when we werepretty much stuck at 4 percent but compare that to other commodities, which export 20, 30, or 40 percent of their production. Our industry needs to look at the shores of Asia, consumers in Europe and markets in South America, not the caves of USDA or the subsidy payments of MILC to ensure our prosperity, stability and future.

One step in the right direction for Federal dairy policy beyond rectifying the two overlapping subsidy programs is to expand the ability to forward contract to those in federally regulated marketing orders rather than limiting it to co-ops and let producers and processors work together to develop new markets and new ways to bring value to milk. It's a simple matter of fairness.

In closing, Mr. Chairman, U.S. dairy farmers and processors can succeed in a free market. We just need to remove some impediments to change and to innovate by looking down the supply chain at ways to add value to milk instead of ignoring these market signals in favor of Government subsidies.

I appreciate the time the committee has taken to come to California to hear our views and to provide us with encouragement and support of our effort to sell high quality dairy products made from U.S. milk to consumers here and abroad. Thank you very much.

[The prepared statement of Mr. Jeter appears at the conclusion of the hearing.]

Mr. GUTKNECHT. Thank you, Mr. Jeter.

Members, I am going to try to get you out of here by noon so if we will all sort of kind of keep an eye on the clock and hold ourselves to 5 minutes and I will try to be a good example. I really don't have so much a question but a couple of comments for the panel.

First of all, Mr. Jeter, I often say this, partly as an auctioneer, that in Washington we can repeal laws and we can amend laws but there is one law that is very difficult for us to either repeal or amend and that is the law of supply and demand. I think sometimes we find ourselves trying to fool around with that and the cure is worse than the disease.

Second, Mr. Dolan, you talked about leveling the playing field and we hear that an awful lot but I learned many years ago when I was a young legislator in the State legislature an old State senator said, "Whenever you talk about leveling the playing field always remember there are about 50 percent of the affected parties who don't want to level the playing field. They have an advantage." That is another thing that we learn as we try to deal with this.

Finally, just for your benefit, I want to say that I am a strong believer in forward contracting and I'm going to say a tribute to Cal Dooley who represented this area for a number of years. He and I worked together very closely and we came very close to coming together with a compromise so that wherever you sold your milk you would have the access to forward contract.

I want to thank you for testifying and I won't use anymore of my time and hopefully I can make a closing statement with that. I will turn to Mr. Cardoza.

Mr. CARDOZA. Thank you, Mr. Chairman. I want to thank this panel. While I don't always agree on the question of forward contracting for some other reasons that we have seen in the past, the people that are represented here truly are innovators in their field and do a fabulous job for California and the country in providing quality products. We have great relationships.

There was a question I had of the previous panel and I want to sort of raise it with you all because from the business side of the industry, the marketing side or whatever, I want to know how it will affect you. I believe that California standards taken nationally will both improve consumer acceptance.

I will tell you that there is nothing more frustrating for me than at certain times of the year to get milk in Washington, DC that tastes like water. I love the California standards here that improve both the quality and the consumer acceptance and the health benefits of whole fluid milk. I am just interested what you think about the proposal that was broached earlier about California standards nationwide.

Mr. DOLAN. Representative Cardoza, as a company we prefer the California standards. It is hard for us to speak for the rest of the country as to what their preferences are. I do know that some other dairies throughout the United States are equipped to handle California standards on a physical plant level but from our company we are in favor of them.

Ms. TAYLOR. As a cheese maker I am not in the midst of that discussion but I just have a couple of observations.

Mr. CARDOZA. I am sort of interested in how it would affect your operation. That is why I asked the question if it would hurt it.

Ms. TAYLOR. In terms of before I get to our own operations, my understanding from some of the consumer research is that those preferences are typically rooted in what you are exposed to as a child so those people who grew up in California are probably more sensitive to the lack of the higher solids levels in fluid milk outside of California.

However, who grew up without the fortified milk have a negative impression sometimes on the more fortified milks. It is not as cut and dried as you might think in terms of an overall consumption impact. As far as how it would impact our business, I don't think that it would negatively impact the Leprino business in any form or fashion. We continue to have a surplus of nonfat solids in this country and those would be absorbed and really neutral probably to us.

Mr. JETER. I am not sure I can add anything to that. Being in the cheese business I am not sure it affects us dramatically. We tend to use more full-fat milk. I tend to agree with you personally I like the milk we have here and it is very good. When I am in other places it isn't the same so I react to that but I am not sure I could add anything more on how that would impact our business, at least in California.

Mr. CARDOZA. We asked the question earlier about research and EQIP and the marketing programs. I think I got a little bit confused as far as the international marketing programs that we do. Out of those programs are you accessing any of those in any way and do they help you?

Mr. JETER. Certainly the marketing programs. We have a local marketing program in California, CMAB, Real California Cheese, that I think has clearly benefited our company and the dairymen that ship milk to us and really all the dairymen in California. We tend to be very supportive of those in general.

Research, we tend to approach that. We put a lot of our own money into proprietary research and try to partner with, for instance, universities who are more dairy oriented. Then we do work heavily with DMI, Dairy Market, Inc., producer funded, to try and leverage what we do back and forth. Those are probably the extent of what we do in our business.

Ms. TAYLOR. We also had a very strong research program that we conduct internally at the company. However, I would say that the research programs that are funded both through DMI as well as university research I think is very important to the industry both on the finished product side as well as obviously the supply is very critical to us.

If I were to put a priority on how the dairy industry be supported, I think some of those programs whether it is research or environmental programs help facilitate the industry to continue to advance to be more competitive. Those are very, very important programs.

There is some funding that goes to the U.S. Dairy Export Council that helps facilitate us getting into the international markets and those markets are very important to Leprino. They are going to continue to become more important to the U.S. dairy industry. I think those things are very, very important.

Mr. DOLAN. We are a regional creamery and we receive most of our milk from within a 350 degree radius. We don't currently export. The only impact the exports do have on us is just ultimately how it filters down through the class changes here in the State. Any wide variations to that do affect us in our marketing in regards to food service and school food service. When we have times of increase in costs the school are complaining. When prices go down they love us. A lot of that does filter down through some of the policies.

Mr. CARDOZA. Thank you.

Mr. GUTKNECHT. Thank you, Mr. Cardoza.

Mr. Costa.

Mr. COSTA. Thank you very much, Mr. Chairman.

Mr. Dolan, thank you again for acknowledging the efforts of Congressman Nunes and those of us who supported his efforts on the milk regulatory act. As you know, it was not easy.

In your testimony it wasn't clear to me. Do you export any—you said you are a regional creamery. Do you export any of your product?

Mr. DOLAN. We do not export any product.

Mr. COSTA. OK. Ms. Taylor, do you export any of your product?

Ms. TAYLOR. Yes. The export market is very important to us on the whey product side in particular with whey protein concentrates and lactose. We have been in that market and developing it since the early 1970's. It is increasingly important on the cheese side. We supply many of the major——

Mr. COSTA. What percentage would you say?

Ms. TAYLOR. On the cheese it is less than 10 percent. On the why products it is more than a third.

Mr. COSTA. And do you think that our Government is appropriately using the tools necessary to allow you to export your products?

Ms. TAYLOR. I believe they are. I very much endorse the attempts to get a leveling of the playing field, so to speak, through the WTO negotiations and think that is critical in terms of expanding our exports. Also in terms of retaining a rational domestic policy because there is still enough disconnects between world markets and domestic markets. We need to get reforms.

Mr. COSTA. Do you think there is a distortion or unfairness of the milk products that are imported between what we export?

Ms. TAYLOR. Currently I would say no. Well, actually I will qualify that. U.S. tariff levels are significantly below those of major other markets, EU, Canada, Japan. We have become more of a magnet for product than what we should be long term under further trade discipline. From that perspective, yes.

Mr. COSTA. Notwithstanding that we other programs that end up bulk supplying milk product here, it seems like the two are kind of in conflict with each other.

Ms. TAYLOR. I am not sure I am understanding your question.

Mr. COSTA. We have other programs within the dairy industry both Federal that have as warehousing a product is what I am saying. The two policies would seem to be in conflict.

Ms. TAYLOR. Yes, I would agree. I would agree.

Mr. COSTA. Yes. Maybe we can figure out that some day.

Mr. Jeter, what percentage of your product do you export?

Mr. JETER. On our whey products it is probably on a tonnage basis 80 percent and on cheese pretty small. I think on a tonnage basis one of the largest agricultural exporters in California. Every day we probably have eight or nine containers a day leaving our facility for the port. It is a big business to us. In the last 60 days we have our own staff in Brazil, China, India, Pakistan, Vietnam, and Japan. That is a fairly regular thing for us.

Mr. COSTA. Do you think we are evenly applying the efforts on trade with those markets you are accessing?

Mr. JETER. It depends on what products you are going into. For instance, the baseline products like cheese tend to be protected, a lot of barriers. Whey products is a lot more fun. There are a lot of opportunities in whey all around the world. It tends to be a much less protected.

Although an example in the EU we pay 70 cents a pound for our high protein whey protein concentrate going into the EU in tariff for human consumption and theirs coming in pays nothing. Beautiful market in Europe. Beautiful. Those are not fair. Yet, that is historical longstanding. We blinked at some point and that is the case.

Mr. COSTA. Final question to both Ms. Taylor and Mr. Jeter and you made reference to it. We are not going to resolve it here this morning but having been involved in it a bit when I was in the State legislature and the chairman made reference to previous efforts, you both alluded—you both testified in support of forward marketing. I think both of you attempted, maybe you to a greater degree, Mr. Jeter, that there could be a win-win situation.

I would like in a minute or two to once again try to explain to me what the win-win situation is. I know what the win-win situation is from your perspective but for co-ops that feel that they have difficulties in meeting some of their challenges, I think this is an issue that they have obviously felt very strongly about.

Mr. JETER. Well, we think it really is a win for everybody. I think we acknowledged here our customers just want a more stable price so we have customers——

Mr. COSTA. But for them.

Mr. JETER. And so what they do is they offer us that stable price. What we are then able to do is offer it back to our dairymen and they can say yes or no, whatever they want. At a time like this we have had customers coming to us and offering to pay, as an example, $1.40 for cheese when the market is $1.15 over an extended period of time.

Obviously they are anticipating markets going up. That offer to a dairyman may be the difference between him getting refinanced or not. It goes to the bank and the bank says, "What's your price this year?" He looks confused or he can say this and he goes, "OK, I will refinance you." It does tremendous benefit and for dairymen it is a tremendous benefit. They have always been just price getters. They just kind of get what is there and forward contracting would allow them——

Mr. COSTA. Most of agriculture are price takers.

Mr. JETER. Well, but they do have markets that they can go into. I agree it is not like they are marketers that are creating markets. On the other hand, I think in the dairy industry 85 percent of the milk is co-op milk and co-ops are formed strictly to make markets. I think that is a tremendous benefit that can be used, too, to make markets. Obviously forward contracting would level that playing field.

Mr. COSTA. Ms. Taylor, second chance at the plate.

Ms. TAYLOR. OK. As I mentioned in my testimony, I believe that forward contracting, being able to offer fixed-forward price to customers does drive demand which benefits both producers and processors in terms of additional demand driving higher prices.

From the producer perspective I agree with John. It is an issue of they have the option of either floating with the market or they can accept this stable price that is offered. There is no requirement that they accept this fixed-forward price offer. If the banker would like to, or if they would like to manage their risk to sign on or they can opt to continue to float with the market so there is no downside. I can tell you that the co-ops continue to have a great demand for this and offer up to their producers because they recognize that producer need.

Mr. COSTA. So tell me, Ms. Taylor, why the members, the dairymen in those co-ops, who make up those co-ops and the board members on those co-ops are made up of dairymen, don't think that is a good idea?

Ms. TAYLOR. Well, I will be very blunt. They do think it is a good idea in terms of them offering that option up to their own producers. What they don't think is a good idea is allowing proprietaries to do that because they would prefer to maintain a procurement edge in the marketplace signing up independent milk. They recognize it is a desired service.

Mr. COSTA. An advantage.

Ms. TAYLOR. Yes.

Mr. COSTA. Thank you.

Mr. GUTKNECHT. Mr. Costa, I would go back to a comment I made earlier that whenever you talk about leveling the playing field I understand there is usually half of the audience that doesn't really want to level that playing field. This may be one of those examples.

Finally I will turn to Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman.

Mr. Jeter, I guess I will go to you first. In regards to forward contracting what stops you or anyone in this room or any dairyman, et cetera, et cetera, from going to the CME and buying or selling a milk contract?

Mr. JETER. I don't think there is anything that would stop that, only in terms of volume and liquidity. The sheer size of that market is limiting so, for instance, we make 480 million cheese a year. We couldn't cover that in that market. That would be a lot to cover so the market is just not large enough.

Mr. NUNES. But it is growing. Does your company participate in—do you buy or sell contracts today?

Mr. JETER. Yes. We developed some innovative ways to facilitate forward pricing. We just have to. I am not one that likes to not compete so we do that and we do some other things that are fairly innovative and legal. We do a lot of different things because to us what our customers need and really what our dairymen want is critical.

Mr. NUNES. So, if I am understanding you correctly on one point, you say the liquidity is not there in terms of there is not as much—not enough open interest available for you guys to utilize the CME?

Mr. JETER. I think that would be true of large buyers and sellers.

Mr. NUNES. But wouldn't an expansion of forward contracting be an impediment to enlarging the open interest on the CME?

Mr. JETER. We don't think so. What we found with dairymen, for one thing, they were just not comfortable with any type of forward pricing. I mean, you would come and talk to them in a business issue sense and they were uncomfortable with it. We have gone through an iteration process of them just getting more comfortable, understanding it, not thinking somebody is trying to steal from them.

It is really a risk management process. We think by having that alternative it will make it easier for some to get involved and, therefore, facilitate even more on the futures market. I think that is the general feeling, at least from proprietaries in the industry, that we need several different vehicles to use. We have found that year by year people get more comfortable with it. In the beginning this was just not almost right, and yet there was no reason other than it had not been done before.

Mr. NUNES. I agree with the assessment that farmers aren't comfortable with something new but, you know, in terms of pork bellies or corn or wheat they are very used to dealing with that. Then we have proprietary businesses like in my district that are grain companies that essentially forward contract feed to dairymen, or the dairymen forward contract, buys the feed contract and they go on to the different boards that are available whether it be Board of Trade or CME and make contracts because there is plenty of open interest and they can do that.

I think it would be much more productive in fixing some of the issues that may or may not be there with CME that were not only in this panel but the previous panel that were mentioned. As Ms. Taylor was very blunt in her testimony about the co-ops wanting the procurement advantage, that possibly is somewhat true but I think you have to remember that dairy farmers own the co-ops and dairy farmers want to work within the co-op.

Since they are owners they would much rather—I think they trust their co-op before they would trust another proprietary business. I think that is the big difference there is that they themselves are making these decisions for themselves in terms of how they are going to forward contract. I understand that you guys could be a little bit disgruntled there but I think there is a difference between a co-op and a proprietary business like yourselves that are not owner operated.

I know you are a little bit of a hybrid, Mr. Jeter, but in terms of most of your milk does come from dairymen that are not owners of your company. As we go down this road I respect your opinion and I know there are a lot of opinions on this forward contracting issue but know that some of us who have a lot of dairy farmers that are members of co-ops they want to protect their businesses that they own. I think it is no different than Leprino or Hilmar Cheese. It will be a hotly debated topic as the farm bill continues.

Mr. Jeter can answer this question but, Ms. Taylor, you talked a little bit about milk protein concentrates. You are both very smart. You said that you were in the banking industry before. How is it that the European Union is able to ship in milk protein concentrate so cheap and basically undercut our market here in the United States?

Ms. TAYLOR. I suspect that you might be referring to markets that existed a few years ago at which time there were heavy subsidies on casein and milk protein concentrate production. For the most part those subsidies have been eliminated. It is in part due to the reforms that have been kicked in due to the Uruguay Round and also in anticipation of further progress. In part due to their budget realities.

I think the price surface has risen substantially on the international market and we no longer have that level of a disruption. I will also throw in there explicitly that Leprino does not purchase milk protein concentrate. We don't use it so I can't quote you the exact competitive price but in the discussions that I have heard in looking at the international marketplace, that disruption is not occurring.

Mr. NUNES. But, however, the plants that produce milk protein concentrate that have been now in existence for probably as much as a decade or more are mostly likely at this point paid for and were subsidized heavily by the European Union and that equipment is now paid for which I think puts us at a huge disadvantage in terms of building our own milk protein concentrate industry here in the United States.

Ms. TAYLOR. The prices for milk protein concentrate internationally will be driven by supply and demand and, yes, maybe those folks will have a little bit more profit margin because those plants have been paid for. Nonetheless, they have no incentive to dump milk protein concentrate into the U.S. market at prices below that which they could achieve in other places. The fact that those plants are paid for does not automatically result in that product being sold at a lower price.

Mr. NUNES. I understand.

Mr. Jeter, would you like to comment?

Mr. JETER. Just to clarify, we do not use milk protein concentrate either and, again, it is something we have never done period as far as bringing it in. United Dairymen of Arizona have been making MPC for quite a while, you know, on the open market. They do a great job and selling a lot of it into Mexico. I know we were trying to market their product.

MPCs are great products and we were excited about it domestic and just doing that, running it through UFs and creating MPCs. We just think it is a great product. Milk protein is beautiful, diverse, unbelievable food ingredient. We should be making it here. I think, frankly, the focus on the support program and other products are the main impediment. I think if we didn't have that focus it would be—I think we should have people looking for markets to make and be competitive and be a little more risk takers than maybe they currently are. We think that might be healthy.

Mr. NUNES. The challenge is, though, what happens to the dairy farmers in the short-term of making that adjustment.

Mr. JETER. I should say that any change like that should be well thought out and done over a long period of time. A lot of physical assets have been put in place and we would certainly need to recognize any big change because we have had these rules we played by. If we did make a change like that, we would need to say where do we want to end out here at some point in the future and then lay out a program to get there.

Mr. NUNES. Thank you.

Mr. Chairman, I want to yield back. I know that you have a lot of tough work to do on the farm bill but I hope that we will be able—I think there was a lot of good testimony today and I hope that we can take some of these ideas that were from all—you had a wide-ranging variety of ideas and I am sure if we were in your district we would have even wider range of ideas. I think there are some things that we can all agree on and I hope that we can move forward on those issues. Thank you again for coming to the San Joaquin Valley.

Mr. GUTKNECHT. Thank you. Let me just say real quickly about milk protein concentrate. I would invite all my colleagues to learn more about what is going on in West Texas and in New Mexico where we literally have groups from the outside, both Kiwis and now from Ireland, who are making significant investments in the United States to make milk protein concentrate here in the United States. I think there is an irony there that sometimes the outsiders have more confidence in our ability here in the United States to compete in a world marketplace than sometimes perhaps we do. Maybe we can learn something from them.

I want to say a special thank you to my colleagues from California for helping to put this together. I especially want to thank them and particularly Mr. Nunes for his work on the producer-handler issue. We have a term that I use in my office about being pleasantly persistent. I think that describes his activities over the last several years and continuing to deal with one particular chairman and that can be extremely frustrating. But he stuck with it and ultimately we did prevail on that.

I also want to conclude this field hearing by thanking all of the witnesses. The testimony is excellent. I would encourage my colleagues and their staff to take with them the binder of the written testimony. I think you will find some interesting nuggets in there that perhaps were not covered in the oral testimony.

I want to thank the county board here in Fresno County for allowing us to use their facility. Without objection the record for today's hearing will remain open for 30 days to receive additional material so if you have letters or comments you would like to put in the official record of this hearing, please forward them to the Subcommittee on Department Operations, Oversight, Dairy, Nutrition, and Forestry.

With that I will announce that the subcommittee's meeting is adjourned.

[Whereupon, at 12:05 p.m. the subcommittee adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF RICHARD COTTA

Good Morning Chairman Gutknecht and members of the subcommittee. My name is Richard Cotta. I am the senior vice president for Government and Producer Relations for California Dairies, Incorporated. I am testifying today on behalf of the 680 dairies who are the owners of California Dairies, Incorporated.

California Dairies, Inc. Background

We are the largest dairy co-op in the largest dairy state in America. Our co-op is the result of a successful 1999 merger of three of California's most financially successful cooperatives; California Milk Producers, Danish Creamery and San Joaquin Valley Dairymen, which all had roots dating back to the turn of the 20th century. Today, our producer-owners have over $100 million in equity invested in the co-op.

We ship over 16 billion pounds of milk annually. Our owners have dairies located from San Diego County in the south to Marin County in the north, with most of the production occurring in the San Joaquin Valley from Kern County to San Joaquin County. We also own five processing plants, located strategically throughout our production regions and plant 6 is under construction in Visalia.

We also have two wholly-owned subsidiary companies: Challenge Dairy Products, which produces a complete line of butter products to the retail trade and food service business; and Los Banos Foods, which manufactures and sells cheddar cheese for manufacturing.We are also the major shareholder in Dairy America, Incorporated, which handles about 2/3 of all the milk powder in the U.S. and exports milk powder to over 40 countries.

Dairy Policy and the Next Farm Bill

I appreciate the opportunity to testify about the current status of national farm policy important to dairy cooperatives and our recommendations for the next farm bill.

Trade Policy. I think it is important to first talk about the next farm bill in the context of trade. With the recent events surrounding the Doha WTO round, it looks like there will not be a new trade agreement in place before the next farm bill is written. However, we continue to support the U.S. proposal that was submitted to the WTO back in 2002, which calls for the elimination of export subsidies and correction of inequities in market access and domestic support. The rational for the U.S. proposal is as important and relevant today as it was five years ago:

- The 1994 WTO Uruguay Round agreement created many trade disparities because many countries were allowed to continue with extensive levels of support, which continue to exist today. These inequities have left the U.S. market relatively open to subsidized competition from abroad, while denying our dairy industry the same opportunities to develop new markets overseas.
- The U.S. proposal is designed to correct inequities, through a balanced approach to 3 key areas: elimination of export subsidies increases in market access, and reductions in domestic support.
- A very key point regarding progress in these areas is the relative levels with regard to each of these issues. For instance, the European Union continues to be able to provide over 1 billion dollars in dairy export subsidies annually, which is 100 times more than U.S. levels. Correcting inequities in this instance will require more than a simple agreement for both of us to cut our subsidies by 50 percent, for instance. That would still leave the EU with the ability to spend $500 million, while the U.S. would essentially have no export subsidy spending.
- Similarly, many of our trading partners-the EU, Japan, and Canada for instance-still maintain triple-digit tariff rates that are simply a de facto export ban, because the tariffs are so prohibitive. Because U.S. tariffs are relatively low, if a trade deal simply calls for a percentage reduction by everyone, there will continue to be severe trade inequities that exist.
- Finally, with respect to domestic support, we feel strongly that allowing other countries to maintain "Amber" box and "Blue" box spending that is higher than our allowable aggregate levels would be extremely detrimental to our dairy producers. Remember that our limit is around $19 billion; the EU can access $60 billion in amber box payments and has an unlimited ability for blue box programs, both of which are trade distorting.

In light of the continued concerns we have about existing inequities in world dairy trade, we are very supportive of the efforts of USTR and USDA in enforcing our rights in our existing trade agreements. Mexico is a big market for us, and we are keenly interested in the situation with Mexico this year. The Mexican government significantly delayed issuing import licenses for dairy products, which it is obligated to do under both WTO and NAFTA.Additionally, there are a wide variety of non-tariff trade barriers-sanitary and phyto-sanitary issues and food labeling, to name just a couple-that continue to create barriers for us in finding new markets, and we really appreciate the efforts of USTR and USDA in dealing with these situations when they arise.Absent a new trade agreement, we urge Congress to reauthorize the Dairy Export Incentive Program in the next farm bill. More importantly, we would urge Congress to consider some modifications to the program to ensure that it is effectively and aggressively used by USDA to us continue to develop new markets and compete in markets where U.S. products are otherwise not competitive because of the presence of subsidized products from other countries. Additionally, we support the reauthorization and funding of the Market Access Program, and the Foreign Market Development Program.

The final issue relating to trade that I want to mention is imports, and there are two areas that I want to briefly discuss. The first is the issue of assessing dairy imports for our research and promotion programs. This was included in the 2002 farm bill but never implemented because of concerns about whether it would pass muster under the WTO rules. We urge Congress to take whatever action is necessary in the next farm bill to get this corrected so that the dairy importers can be assessed their fair share. They have been getting free rider benefits from our research and promotion activities for years, and it is past time to correct this inequity. The second import issue is milk protein concentrates (MPCs). Imports of MPCs have increased phenomenally in the past few years, and these products are clearly displacing domestic milk products. We have the capacity to produce MPCs ourselves, but we cannot do so under current market conditions, which are largely due to heavily subsidized imports. We think the U.S. policy should be one that encourages and allows growth in our domestic capability to produce MPCs, rather than outsource yet-another portion of an industry to other countries. This could be achieved either through establishing a tariff on imported MPCs, or through some kind of a processing subsidy for domestic MPC production. We urge you to consider this during the next farm bill.

The Commodity Credit Corporation Price Support Program Works and Should Remain Intact. We believe that the current dairy price support program, under which CCC supports the price of milk at $9.90 per hundredweight and the price of nonfat dry milk of approximately $.90 per pound, have served the industry very well, and should be continued in the next farm bill.

These support levels do not guarantee a profit for any dairy producer; indeed, these purchase prices are still below everyone's cost of production. However, the price support program does give our industry an avenue for dealing with situations where supply and demand are out of balance without leaving dairy producers in permanent financial ruin.

We believe that the price support program also represents a good Federal policy because the benefits outweigh the costs. The best recent illustration of this occurred right after the 2002 farm bill was signed. The gross cost of the dairy purchase program between July 2002 and June 2003 (a period of 25-year low dairy prices) was approximately $600 million, excluding revenues received by USDA for selling product back into the market and the value of any products used in donation programs. However, industry estimates are that, without the dairy price support program, producer prices would have been about one-third lower, which would have resulted in $2.4 billion reduction in income for dairy farmers during that time.When dairy prices are above the CCC purchase levels, there is no cost to the Federal Government. There have been almost no CCC purchases or costs during fiscal year 2005 and the first half of fiscal year 2006, proving that the program is truly a stand-by safety net program. The National Milk Producers Federation, of which we are a member, estimates that the dairy price support program, as of June 2006, has prevented a $3.5 billion loss in dairy farmer income, at a gross cost of product purchases of approximately $1.1 billion.

One other issue within the dairy price support program that merits some attention is what is commonly called the "butter powder tilt," which is the relative support prices between butter and nonfat dry milk. The 1996 farm bill allowed the Secretary of USDA to make adjustments to the tilt not more than twice a year, and this same authority was continued in the 2002 farm bill. We understand the need for the Secretary to have some discretion in adjusting relative prices in order to minimize costs to CCC, as he is directed to do by the law. However, from a business perspective, changes to the butter/powder tilt are extremely disruptive. When there is even a rumor about the Secretary contemplating a change to the ratio, there is often a chilling effect on pending dairy product sales and purchases, because even a small change in the tilt can have a dramatic economic effect on pending transactions. Accordingly, we are in favor of continuing to limit the authority of the Secretary to make no more than two changes per year, and would support a limit of once per year.

The dairy price support program is efficient and effective, and we believe that it is the most equitable dairy program because it treats all producers the same, regardless of size or location. We strongly support the continuation of the dairy price support program at current levels in the next farm bill.

The Milk Income Loss Compensation Program Should Be Terminated. During the formulation of the 2002 farm bill, we were supportive of NMPF's efforts to include a supplemental payment component for class III (cheese) and class IV (butter and nonfat milk powder) as part of the dairy safety net even though California has its own state marketing order system. However, as you well know, Congress enacted the MILC program instead.

The MILC program is fairly divisive within our industry, due to the fact that it mainly benefits small producers. Because the producers in our co-op do not receive much benefit from the program, we believe that the Federal resources that have been devoted to the program would be more effectively used in other ways. Put another way, we are certainly not in favor of extending the MILC program if it comes at the expense of the dairy price support program.

Conservation Programs Are Vital. California, and the San Joaquin Valley in particular, is at the forefront of just about every environmental issue being faced by agriculture producers today. We are constantly being faced with a barrage of issues dealing with clean air and clean water, with the end result usually involving more regulatory costs of compliance to our producers.

We are very supportive of the Environmental Quality Incentives Program (EQIP), which Congress reauthorized as part of the 2002 farm bill. Projects funded by this program in California are helping our producers to cope with the continually-increasing costs of complying with environmental regulations. We can assure you that any additional funding or increases in the cost-share allowance you can provide for this program will be put to good use.

Because The Conservation Security Program (CSP) is so limited in the number of watersheds in which it is being used, we do not have any way to evaluate its effectiveness. We would hope that, if the program is continued in the next farm bill, we can work with Congress to expand the program so that it can be beneficial to dairy producers who want to contribute to watershed quality improvements, which we all do anyway.

Environmental Research Is a High Priority. The last several farm bills have continued to emphasize the need for good research in a variety of areas, all of which are important to agriculture. For the next farm bill, we believe that we need to significantly increase the focus of our research efforts in the environmental area. For example, in California we are currently doing air quality research on dairy farms to determine the sources and levels of volatile organic compound emissions. One research initiative actually involves measuring methane emissions from dairy cows inside of a sealed chamber; other efforts include looking at methane emissions from feed piles. The dairy industry has recognized this need nationally as well. Last year the industry asked Congress to allow us to use a small portion of our dairy research and promotion check off dollars for environmental research associated with EPA's consent agreement, which is vitally needed by the industry to get some good science as we continue to look for ways to control and understand how greenhouse gases work.

We think the need to focus research into this area will help us to better direct our conservation program dollars. For instance, if our current research ends up showing that different management practices with respect to silage piles can result in more methane emission reductions than covering a manure lagoon, the eligible activities under EQIP could be expanded to include dairy feed management practices in order to encourage producers to adopt these practices.

The dairy industry, along with the rest of the agriculture sector, knows that our best bet in being able to minimize the costs of environmental regulation is to make sure we have good science to back up any of the decisions we make with respect to air and water quality. By including environmental research as a priority in the next farm bill, you will be helping to ensure that we have sound science to back us up as we address environmental issues.

Federal Marketing Orders. Our producers operate under California's state milk marketing order program. Because of this, we do not take positions on proposals to reform or change Federal milk marketing orders. If you make changes to the Federal marketing order structure that would necessitate a change in our system, our system allows both producers and processors to request a hearing by the California Department of Food and Agriculture. Within 60 days, we could have a decision on whether a change will be made or not. We may not like the result, but at least we have a system where we can get an answer in a relatively short time, which would minimize any potential adverse effects that might be created by a significant change in the Federal order system.

Thank you for the opportunity to testify today.

STATEMENT OF JEEP DOLAN

Mr. Chairman, members of the committee, thank you for this opportunity to testify. My name is Jeep Dolan, I am vice president of operations and co-owner of Driftwood Dairy and I want to thank you for coming to California. I want to share with you my unique perspective on some of the challenges of the current dairy policy as it relates to small, family-owned dairy businesses.

I understand our time today is short; the issues are complex and I am far from a policy expert—so I will try to get to the heart of the matter in a straightforward way. First of all, however, let me set some context by telling you about Driftwood Dairy and our role in supporting dairy producers.

Driftwood Dairy has been in business since the early part of last century. My great grandfather ran a Dairy in Los Angeles in the 20's, 30's and later moved to El Monte in the thirties until his retirement in 1942. Uncle purchased Driftwood Dairy in 1946 at our current location. Driftwood Dairy sells fluid milk products, juice, cream and ice cream mixes. Seventy percent of our business is food service and co-packing for other manufacturers. Driftwood is probably the number one or two supplier to School Food Service programs in the country. While we may be considered a small player on the industry stage our presence in local communities, in the state and nationally is large.

Clearly, our industry is a critical link in the farm-to-table economy that ultimately supports dairy producers. We are forced to operate under some Federal policy constraints, however, that prevent us from being more efficient in our role as linking producer to consumer. Let me discuss a few concerns here today:

- Congress needs to ensure there is a level playing field so everyone can compete fairly.
- Congress needs to ensure the Federal regulatory system is more responsive to industry change.
- Congress needs to review and phase out the ineffective and market distorting dairy price support program.
- Congress needs to help the industry guard dairy's franchise on wholesomeness and nutrition.

First, I would like to thank members of the Committee for helping to level the playing field by passing the Milk Regulatory Equity Act. Driftwood operates in the California state order and the Arizona Federal Milk Marketing Order (FMMO). So, we have first hand experience with the problems created by an uneven playing field. Whether you are big or small, coop or processor, no one should have preferential treatment. No one, whether producer-handler, large processing company or large cooperative, should be able to use legislatively created advantages to "run the table" on other processors and producers. This was wrong when it was tried by producer-handlers and Congress was right to step in and fix it. Dairy processors and dairy farms are fundamentally business operations and should be treated as such. I would advise the Committee that you should strive to be fair to everyone in the industry and not think good public policy can result from giving an advantage to one group or region over another.

Second, Congress needs to ensure that Federal regulatory system is more responsive to industry change. If Congress decides that the Federal Milk Marketing Orders should continue to regulate price, then the system needs to function in a manner that allows the market to operate. I do not believe Congress should have to step in and fix every little problem. USDA and the Marketing Order regulators should be able to do it, but they need to act in a timely fashion. The producer-handler issue is a good example. It took USDA years to resolve some of the issues associated with producer-handlers. While all along these farmer-processors used the delay to gain an unfair advantage in the marketplace. Regulation should be helpful—not harmful. Economics and the laws of supply and demand should dictate the rules in the marketplace, not regulatory delay or bureaucracy. It takes USDA an average of 9 months to make the smallest of changes to the Federal Milk Marketing Orders. Why is that? This is not "rocket science."

Third, Congress needs to look at the old subsidy program, the dairy price support program, and phase it out. While the concept of an economic "safety net" for producers is a sound and appropriate goal for Federal dairy policy, the current price support program is creating major distortions in commerce. Driftwood used to be a commodity producer in the 1980's and saw first-hand, the problems and unintended consequences of the USDA "give away" programs because of the surplus purchases under the dairy price support program. I remember that the non-fat dry milk we received sometimes was probably a year old or older, and it arrived at our plant on the bed of the floor of a truck because USDA wouldn't exchange pallets. Nowadays, I would refuse such a delivery because it violates Federal safety standards, such as HACCP, and good manufacturing practices (GMPs). We cannot continue a program that creates a "secondary market" for dairy products that may foster cutting corners to make a buck. The image of the dairy industry as one dedicated to quality and meeting consumer demand is too important to jeopardize.

Some cynics might ask, "Why would processors care about the Government buying up the surplus milk powder?" The answer is simple; we are in the business of being the link between dairy farmers and 90 percent of all consumer households in America. Government does not operate well in this free enterprise environment. However, this is exactly what is happening with the dairy price support program and it isn't working. There has got to be better ways to support all dairy farmers equitably without having the government attempt to stabilize prices by purchasing surplus dairy products and then getting rid of them in ways that cause real disruptions in the flow of commerce. The program should be phased out.

Fourth and lastly, instead of price controls, strict regulations, government intervention in the marketplace and expensive subsidies, Congress needs to help the industry guard dairy's franchise on wholesomeness and nutrition. Dairy is one of the most nutritious and beneficial foods. You might not believe that we are competing with soda companies but we are. What do you reach for when you are thirsty? Our industry is changing and the nature of our products needs to change with consumers. But we are so strictly regulated as it relates to our ingredients and prices, it frustrates our ability to compete with other companies that are not subject to the myriad of regulations that dairy companies are. The issue of a level playing field should apply here, too. As I mentioned when I started, Driftwood is a leading supplier to School Food Service programs in the country. Therefore, what happens to us on the milk and agriculture front ultimately affects our ability to provide schoolchildren with milk, juice and other dairy related products.

We are a small processor in a big industry. Congress has an obligation to help businesses like Driftwood as well and the big dairy companies and coops. My family has been involved in the dairy for four generations even long before Driftwood and I am dedicated to making it profitable and successful for future generations of our family. We see a myriad of opportunities to grow and prosper but we need your help to level the playing field and break down some of the old bureaucracy that is standing in our way. We cannot be hamstrung with old regulations or a view of the industry that does not comport with the realities of today's marketplace if we are going to remain vital and successful.

Mr. Chairman and members of the Committee, thank you for this opportunity to testify.

Statement of John Jeter

Mr. Chairman, and members of the Committee, thank you for the opportunity to testify here today. My name is John Jeter, and I am the CEO of Hilmar Cheese Company.

Hilmar is a unique company. We are a producer owned, private company that buys over 10 percent of all the milk in California. We are now in the process of building a new cheese processing plant in Dalhart, Texas. This new cheese and whey protein processing plant in Texas will be the company's first processing plant outside of its Hilmar, California facility and corporate headquarters.We were founded to increase the prices producers receive for their milk, and we have been very successful, despite Federal regulations and programs that were originally intended to help producers but actually stand in the way and handicap the whole of the US dairy industry.

The next farm bill provides Congress with a tremendous opportunity to bring more cohesion to our fractured dairy programs and to recognize and rectify the unintended consequences of the well-intentioned but flawed programs in place today.

Let me start by offering one example of such a well-intended program that is actually retarding natural growth and progress in the industry: the Milk Income Loss Contract program—otherwise known as M-I-L-C. It is symptomatic of Federal dairy policy today and I am sure the Committee has heard differing opinions on the program. I am here to report that I believe the program is counterproductive, expensive, and it is unnecessary.

The MILC program is counterproductive because it works at odds with the dairy price support program. The price support program was once intended to clear the market of excess production, but now it simply stimulates excess production and keeps prices low. The MILC payment compounds the market distortions by subsidizing the excess production and further lowering overall price levels, which is detrimental to all in dairy. These two programs are simply incompatible.

USDA's 2004 analyses of the programs confirm this determination. USDA's Deputy Chief Economist Dr. Joe Glauber explained it this way at a recent Senate hearing on dairy policy—he said the MILC programs works "at cross purposes with the underlying market price support program if you're creating incentives to produce more milk, well then that can potentially cause a price decline." He explained when this happens, "the government steps in and purchases product." He went on to testify the current system creates, "stock piles that end up growing quite large", "potential product imbalance" and distortion in the markets.

On top of all this, the MILC program is also expensive. It was meant to be a temporary assistance payment to dairymen; a transition program from the failed Northeast Dairy Compact, conceived in 2002 during the farm bill debate, but by the time it was implemented it was extended retroactively to 2001. Based on its March 2004 estimate, the Congressional Budget Office projected that the cumulative cost of the MILC program over its expected four-year life was going to be approximately $3.8 billion. This is significantly higher than estimates offered in 2002 during the farm bill debate, when the CBO estimated total direct payments of only $963 million over the life of the program.

MILC was supposed to sunset in October 2005, but Congress extended this program through 2007. Ironically, it was the budget savings bill, the measure to cut Federal spending, which extended MILC at a cost of another $1 billion, at least.

MILC is unnecessary and counterproductive. There exists another program designed to prop up farm gate prices of milk—the Federal dairy price support program. In the next farm bill, we need to resolve which of these programs, if any, to keep and which to get rid of. Neither are ultimately truly helping producers, processors, or consumers. In fact, by the time the MILC payments kick-in, after the price support program, taxpayers have paid for the same milk twice.

While as I said at the outset, Hilmar is dedicated to delivering better prices to dairy producers, we do that through adding value to their milk and supplying the market with what consumers want. That is how Hilmar is different, we do not expect the government to help us meet expenses or guarantee a profit. That is not a formula for success in our free enterprise system.

Our focus is on making world class cheese and value-added whey products, so to me the current two programs we have now in dairy do not make sense. Why are we paying producers to make a product i.e. non-fat dry milk that is not being demanded by the marketplace but that has the best return when it is sold to USDA to be stored in a warehouse?

The dairy price support program may be guaranteeing a price to producers, but it is not adding value to their milk, nor is it serving consumers who ultimately determine the value of milk and dairy products. What the dairy price support program does accomplish is to stand in the way of innovation in products and in the way of investment in technology.

Fundamentally, what Federal dairy policy does today is ignore the law of supply and demand. It focuses in on getting more money to the producer . that in most cases means more production. A critical missing point in our policy discussions is: where will this milk go?

In the next farm bill I would urge you ask a simple question. Is it really sustainable to subsidize production with the MILC program . and then take that milk off the market through the dairy price support program and keep it in government warehouses? As far as I can tell, the "demand" for non-fat dry milk by Federal warehouses is probably pretty limited.

On the other hand, the demand from the market for cheese, new and innovative consumer demanded, value-added dairy products, domestically and globally has barely been tapped in any real and significant way. In addition to US consumer demand for new, interesting and quality products, there is a demand for specialty protein products from food manufacturers and there is a growing export demand. Consider this: the US exported 7 percent of its production last year . a big increase from a few years ago when we were pretty much stuck at four percent . but compare that to other commodities, which export 20, 30, or 40 percent of their production. Our industry needs to look at the shores of Asia, consumers in Europe and markets in South America, not the caves of USDA or the subsidy payments of MILC to ensure our prosperity, stability and future.

One-step in the right direction for Federal dairy policy beyond rectifying the two overlapping subsidy programs is to expand the ability to forward contract to those in federally regulated marketing orders rather than limiting it to co-ops and let producers and processors work together to develop new markets and new ways to bring value to milk. It's a simple matter of fairness.

In closing, Mr. Chairman, US dairy farmers and processors can succeed in a free market. We just need to remove some impediments to change and to innovate by looking down the supply chain at ways to add value to milk instead of ignoring these market signals in favor of government subsidies. I appreciate the time the Committee has taken to come to California to hear our views and to provide us with encouragement and support of our effort to sell high quality dairy products made from US milk to consumers here and abroad.

Thank you.

Statement of Leroy Ornellas

I am Leroy Ornellas, a dairy farmer from Tracy, California. My wife, Jennie and our three sons, Kevin, Mark, and Mathew, operate two family dairy farms near Tracy. Our family milks a total of 630 cows and produce nearly 14 million pounds of milk over the most recent 12 months. I am the third generation on the farm my sons are fourth generation and our grandkids are the fifth generation, all working on the farm. We market our milk through Dairy Farmers of America, Inc. (DFA), a national milk-marketing cooperative based in Kansas City, Missouri

I am a member of Western United Dairymen. I am on the Board of Supervisors for San Joaquin County. I am a member of the Council of Government, the Local Agency Formation Commission, and the Delta Protection Commission.

I appreciate the opportunity to testify at this hearing today. I have a written testimony document that is more detailed on all of the points that I will touch on today. I'd like to submit that document for the committee's reference.

While organizations that I serve have not officially established positions for all of the 2007 farm bill issues, I would like to share my thoughts on some of the major themes that will define the dairy sections of the bill.

(1) DFA members are participating with all the other members of the National Milk Producers Federation's Dairy Producer Conclaves to develop a consensus position on farm bill issues. We will keep you and your staffs informed of our efforts and seek your counsel on issues as we discuss them.

(2) Because we do not think there will be radical shifts in policy direction as a result of the 2007 farm bill we support the view that an extension of the current farm bill which will work well for most of the nations dairy farm families.

(3) We feel the next farm bill should maintain some form of an economic safety net for dairy farmers. Because dairy products are such an excellent source of nutrition for our nation and due to the high fixed cost of becoming a dairy farmer and the fact that milk production assets have limited use in any other agriculture enterprises, past Congresses have maintained safety net provisions for the dairy industry. We hope this Congress will continue these policies.

The most important safety net provision we have is the dairy price support program. We favor continued operation of the dairy price support program at a targeted $9.90 U.S. average manufactured milk price. We would oppose granting the Secretary of Agriculture any discretion, which would reorient its intended purpose away from supporting income to farmers just to result in minimizing government costs—and we may need Congress to instruct the Secretary of Agriculture of this fact in some official manner. Under President Bush's proposed agriculture budget the Secretary of Agriculture would be allowed to adjust buying prices for products made from milk (cheese, butter, and nonfat dry milk) so as to reduce the cost to the CCC for products purchased. This could allow for a reduction in targeted support price from that $9.90 as specified in present legislation.

Additionally, I would request that the Commodity Credit Corporation (CCC) take action and adjust the support program purchase price levels for cheese, butter and nonfat dry milk to reflect the significant additional costs manufacturers face when selling products to the CCC. The current CCC purchase prices for dairy products do not reflect any costs beyond those incurred for commercial sales. As a result, market prices for individual products have, from time to time, fallen below support levels, allowing the price of milk used to produce them to fall below the statutory support level for milk of $9.90 per hundredweight at average test. NMPF has provided information to CCC but thus far CCC has been unwilling to take action. The result is that manufacturers will sell to buyers other than CCC at prices below the support level in order to gain a higher value than the support purchase price and the support price targets are not maintained.

Up until the last several months, the CCC has purchased some NFDM—doing what safety nets are supposed to do. The last time milk prices fell to safety net levels was in 2000 when the average class III price for the year was $9.74 (below the safety net price of $9.80 for milk of 3.5 percent butterfat test). The 10-year average class III price is $12.62. Because the price support program is in place and working we hope to avoid a price crash like in 2000—but if it wasn't around and prices did fall to that level the Ornellas farm would face a loss in income of $402,439 on the most recent years production. That would be hard for our business to withstand. We are very interested in stable policies that help to keep reasonable prices and a safety net that maintains some level of viability for a dairy farm family.

The second safety net provision is the Milk Income Loss Compensation (MILC) program, which DFA supports as long as there are no caps limiting access to the benefits. My farm is affected by the payment limitations, restricting my ability to fully take advantage of this program. Like the price support program I view the MILC program as a valuable safety net for producers pay prices. Its key benefit is that it puts cash in the hands of farmers at the very point it is needed most—the lowest point of the price cycle.

In general the guidelines for a safety net program should be that the program:

- not discriminate between farmers of differing sizes;
- not discriminate between farmers in different regions of the country;
- not be high enough to encourage additional milk production.

The government's safety net policy should only operate at a point where a collapse of producer prices could force too many producers out of business and our nations milk-producing infrastructure would be damaged.

(4) We support continuation of regulatory milk marketing order programs like the California State Order and the Federal Milk Marketing Order system. Marketing Orders are important to us as they undergird all of our marketing and pricing efforts all over the country. Orders assure dairy farmers a minimum price, assure that all competing milk buyers pay the same minimum price, assure that all dairy farmers share equitably in the returns of the marketplace and assure that the terms of trade are uniform throughout the Order's marketing area. These objectives remain very important ones in the dairy marketplace. Moreover, despite the claims that they are outdated and not relevant, the primary reasons for the institution of milk orders still exist: There are many more buyers than sellers and the average sized milk buyer is much larger than all but the very largest dairy farms. Milk production is still very seasonal. Milk demand has a weekly and seasonal purchase pattern that requires substantial costs to balance producer supplies with buyer demand. Individual dairymen, and even large groups of dairy farmers, continue to need the stability of Orders to deal with these marketing challenges.

(5)A majority, but unfortunately not all of the nations dairy farmers, have funded and are operating a self-help program—Cooperatives Working Together (CWT). Dairy farmers voluntarily pay 10 cents per hundredweight on all milk produced in order to structure the size of the nations dairy-cow herd and more closely tailor milk supply to demand. Additionally, the program works to assist exports of dairy products in an attempt to market and promote domestically produced dairy products to the world. Over the three-year period of the CWT program, participating dairy farmers have contributed over $213 million, which to date, was used to remove a total of nearly 3.2 billion pounds of milk from our domestic market.

However, the CWT program is not intended to replace Federal farm programs and can never do so because there will always be those who choose to take advantage of the programs benefits but never pay their share. Even after two years of successful implementation there are still over 25 percent of the country's dairy farms that choose not to pay in. In spite of our success we still need Congress's help in providing policy support to our industry.

(6) Dairy Farmers also see policies outside of the farm bill impacting their future such as: Environmental Policies

The implementation of conservation practices on our farm is extremely important to our operation. Increasing the funding for the Environmental Quality Incentives Program (EQIP) in the 2002 farm bill was very significant. Without the cost sharing mechanism it would have been difficult to fund some of the necessary and recommended practices.

I want to thank you Chairman Gutknecht for cosponsoring HR 4341 as part of a bipartisan effort to clarify that animal manure is not a hazardous waste under the Superfund law or its counterpart, the Community Right-to-Know Act. Congress should clarify that it never intended to jeopardize American agriculture by imposing strict, joint, several, and retroactive CERCLA liability on farmers for their traditional farming practices, including the use of manure as a beneficial fertilizer. I would ask you to urge your colleagues to support this important legislation.

My family has always taken our responsibility to protect the environment very seriously. Dairy farmers and other agricultural producers for years have been regulated and required to have permits under the Clean Water Act, Clean Air Act and numerous state laws and regulations—but never under the Superfund Law. It is essential that Congress protect farmers and businesses that depend on agriculture from this potential threat to their livelihoods.

ESTATE TAX ISSUES

We favor the elimination of estate taxes. If this is not possible, we would be in favor of any compromise that reduces the estate taxes.

(7) Another reason we support extending the current farm bill is so that we can have a more clear view of the WTO trade talks. We can see no reason to change our programs until we know what the world trade rules will be and more importantly perhaps who will play by them.

• We support multilateral trade talks that level the playing field of dairy export subsidies, tariff protections, and domestic support programs.

• We can't support a final agreement unless it represents a net increase in our ability to compete against our more heavily subsidized and protected competitors in the EU, Canada and Japan, as well as more balanced trading opportunities with key developing countries.

• We support the continuation of the dairy price support program with or without a successful Doha Round. We strongly disagree with those who claim that the price support program must be phased out or eliminated upon completion of the Doha Round.

• DFA's dairy farmer Board endorsed a renewal or an extension of the President's Trade Promotion Authority to advance the U.S. dairy industry's trade interests.

• We support additional legislation to make the import assessment for dairy promotion (15 cent check-off) WTO-compliant by including dairy producers in Alaska, Hawaii, District of Columbia and Puerto Rico. Their inclusion will allow the collection of the promotion assessment on imported dairy products as authorized in the 2002 farm bill. Such legislative action is obviously long overdue.

(8)We support the Dairy Export Incentive Program (DEIP) and the requirement that the Secretary of Agriculture be directed to see that the allowable amounts of cheese, butter and nonfat dry milk be afforded export assistance equal to what we are allowed under the current WTO agreement. Currently no government export assistance is being offered, even though, by law, the Secretary is directed to do so, and by agreement we are allowed to do so under the WTO agreement.

(9)Finally we support Senate Bill 1417 offered by Senator Craig that impose tariff rate quotas on certain casein and milk protein concentrate products. Our current tariff rate quota schedules for dairy products were written before these products were mainstream dairy ingredients. Like all other policy areas this section needs to be reviewed and updated to reflect today's economic realities. Regulatory personnel are dragging their feet on this issue and interest from Congress can help to accomplish the task.

In closing, Chairman Gutknecht, I want to thank the House Agriculture Committee specifically your Subcommittee for having this field hearing. We know we can't explain all of our concerns here in detail but want to make you aware of them so that when we do provide you with additional details you will better understand our concerns. I will be happy to answer any questions, or provide any additional information that you might want.

STATEMENT OF SABINO HERRERA

Good morning Mr. Chairman and members of the committee. Thank you for holding this important hearing today and welcome to our great state of California. My name is Sabino Herrera and I'm a veterinarian and dairy producer with the Hilmar Cheese Company.

I did not grow up on a dairy farm. I grew up in the inner city of Los Angeles but learned the love of dairying and dairy medicine at the large scale operation in California's Central Valley.

I might have a different perspective than others on the panel, maybe even than other dairy farmers you have heard from as I am not a proponent of the so called dairy safety net program. I'm here today to convey to this committee just how important it is for us to revisit our current two-part dairy support program and for us to make meaningful and sensible reforms that are fair to all farmers.

As you already know, there are currently two subsidy programs in place, both with the goal of helping producers like myself. One is not very popular in states with large dairy operations like California, the Milk Income Loss Contract (MILC) program. The other program is the USDA's Dairy Price Support Program that has existed for decades and works at cross purposes with MILC. But, together they lower milk prices and decrease dairy productivity.

Let me explain why MILC is so unpopular in this growing part of the dairy world. MILC is not a true safety net for all dairy farmers. Instead it encourages farmers to produce more milk because it keeps some farms in business that are not profitable on their own. At the same time, the price support program buys up whatever surplus cheese, butter and non-fat dry milk produced by these same farmers as another form of support. And to make matters worse, USDA then has to find means to get rid of the surplus by reselling these dairy products or simply giving them away. This, in turn, significantly disrupts the marketplace, which affects all farmers. Even the USDA has said that the two programs are at odds with each other and decrease farmer income. This situation should not be allowed to continue.

Nearly $2 billion had been spent on MILC payments prior to the recent extension. That amount far exceeded the original estimates for the program. And truthfully, the money has only helped a limited group of farmers. One reason milk prices were so low for so long in 2002 and 2003 was because of MILC payments. These artificially low dairy prices were the direct result of a Federal system that failed to protect all farmers.

Committee members, I urge you to do away with the current system and start fresh with the creation of a single, sensible dairy program that achieves the purpose of providing dairy farmers with a safety net while protecting prices for consumers. This change is vital for the sustainability of many dairy farmers across the country and needs to happen sooner rather than later. I hope Congress can find the right vehicle to implement this overhaul.

Let me be clear of one thing. By advocating for a single system and not the current dual programs, I am NOT suggesting that dairy farmers need less financial help and funding. Rather, I believe that resources saved from the consolidation of the two existing programs can instead be used to support farmers in many other important areas.

Dairy farmers are constantly struggling to keep up with the changing times and will continue to need help and resources dedicated to address new issues. In the immediate future, dairy farmers, as a group, will have to concentrate on finding innovative ideas for sound environmental management practices and conservation. We also have to tackle the implementation of new technologies and meet the demands of creative promotion of our products.

I did not know when I was young that I would be a vet and a dairy farmer. I entered this business after a very positive experience at a well-run dairy farm operation. We need programs to help young people get into the business of agriculture. Dairy farming is hard work, but it is a business and we should not have to be dependent on government programs to make our livelihood.

What dairy farmers need is help dealing with real on-farm issues. In the West, we struggle with water conservation and environmental compliance. Federal dollars could help us met these challenges, as well as help us become energy independent through the use of methane digesters. As a vet, I can tell you we could use more Federal dollars for Johnes disease research and eradication, and to guard against foot and mouth and mad cow diseases. What we don't need is to be tied down with the same unfair and costly support system that we have been saddled with for years while real on-farm needs go neglected.

I want to make sure you know I am not talking about giving us more and more money. We just need your help to make sure that Federal dollars are targeted at helping dairy farmers across the country. We certainly do not want money to go to new, hastily created programs like MILC or arcane, outmoded programs like the price support, but rather to programs that help grow our business.

Mr. Chairman and members of the committee, I am optimistic about my future and about the health of dairy in the Central Valley, but I am deeply concerned about the current dairy subsidy system. An overhaul of the dairy program in the next farm bill is essential for creating effective policy that will stabilize the dairy industry and enable us to continue to have healthy, high quality farms and produce dairy products that the public wants and enjoys.

I thank you again for holding this hearing here in California's Central Valley and I look forward to your questions.

US House of Representatives
Dairy Subcommittee on Operations, Oversight, Dairy, Nutrition, and Forestry Field Hearing
September 16, 2006
Fresno, CA

Testimony of:
Dino Giacomazzi
Giacomazzi Dairy
Hanford, California

On Behalf of:
Western United Dairymen

Good morning Chairman Gutknecht and members of the committee. I want to thank you for holding this House dairy sub-committee field hearing today and allowing me the opportunity to provide input on current and future federal farm policy on behalf of the dairy producers. My name is Dino Giacomazzi and my family has been milking cows and farming in Hanford, CA since August of 1893. For the past 113 years my family has prided themselves in being involved in their community and industry and it is an honor for me to be here today. We currently milk 950 head of Holstein cows, farm 500 acres of forage crops and are members of the Land O' Lakes Cooperative.

I am also a member of Western United Dairymen, a trade association representing over 1100 California dairy families. Currently, I participate on their environmental issues committee. I am a member of the National Milk Producers Federation's Environmental Task Force, a board member of the Kings County Farm Bureau, and am currently participating in class 36 of the California Ag Leadership Program.

In the spring of 2006 persistent and late season rains virtually ruined first-cutting alfalfa and damaged much of our wheat crop. Many acres of wheat which were slated for silage ended up as grain and for the first time in recent memory silage wheat prices matched the much higher valued corn silage. The price of corn has increased considerably due to higher costs in trucking and rail, and demand for corn from subsidized ethanol plants is taking up an ever-increasing share of the market.

This brings me to a little side note. I believe California dairies should receive some sort of environmental credit for playing a major role in the construction of ethanol plants here in California as well as across the country. You see, ethanol plants distill corn into fuel and at the end of the process there is a by-product. Because of the cost of energy in California, it is not feasible for ethanol plants to dry and store this by-product called distiller's grain so they must distribute it wet. The ethanol plants depend on the cows in California to eat this wet distiller's grain. If it weren't for the cows, the likelihood of ethanol plants being built in California would be very low. Not only are the cows utilizing the waste from the ethanol plants, much of the VOC emissions from the wet distiller's grain are being shifted from the ethanol manufacturer to the dairy operator.

In addition to losses from rain, California's dairy industry suffered a tremendous blow when a record heat wave struck the state taking the lives of more than 31,000 head of cattle. The heat also caused a major loss in milk production, affected the reproduction of our herds, damaged crops, and caused an estimated economic loss of more than half a billion dollars just in the eight counties of the San Joaquin Valley, as reported by county Ag commissioners. This number does not include crop losses which are yet to be determined.

Secretary Johanns has declared the affected counties a disaster area eligible for relief; unfortunately, today there is no program that would adequately compensate California dairy families for their losses. We ask congress to assist us by funding those programs which will help recoup some of our losses during this period of low milk prices and high production costs.

Two major challenges facing the California dairy industry going into the future are large-scale environmental regulation and over supply of raw milk. We have come under more intense pressure to comply with local, state, and federal air and water quality standards. Based on independent research done by McKinsey & Company, the total cost of environmental compliance to California dairy producers could range from $650 million to $2.6 billion depending on the stringency of the regulations. With these estimates, potentially only 6 percent of today's farms have the profits to cover the high fixed costs of compliance. That equates to a dairy of 2500 cows or more.

To top it all off, an ever increasing percentage of the dairyman's work week is being filled with regulatory paperwork. What the dairy farmers are asking of our government is a harmonization of implementing clean air and water regulations and reporting for agriculture. It is not necessary for a local, regional, state, & federal inspector to visit our farms looking for the same thing; additionally it is not necessary for dairies to fill out multiple versions of the same paperwork for these agencies. We would like to encourage more memorandum of understanding arrangements between these agencies. Furthermore, any regulation, environmental or otherwise, should be based on sound science and not adopt a "shoot first, ask questions later" reaction to frivolous lawsuits.

The second issue is the oversupply of raw milk. Increases in per cow production, and overall number of cows could lead to historical trends in growth outpacing projected demand.

Another factor contributing to the increasing supply of milk in California is a cycle of selling small dairies on valuable land and using the proceeds to purchase larger dairies. As land values appreciate with the encroachment of urban sprawl, farmers sell their small 300 to 500 cow dairies and invest that money into larger 2,000 to 5,000 cow dairies. Current tax policy intensifies this cycle of reinvestment. The capital gains laws encourage farmers to invest the proceeds from the sale of one dairy into another because of the "like-kind" rule, whereby a person can defer tax on capital gains by reinvesting those gains into a similar asset.

Mr. Chairman, it's hard to find positives given these conditions I've described, but you've asked me here today to discuss the Farm Bill and I can tell you there are many good things about that bill. The Dairy Price Support Program came into play early in the life of the Farm Bill, was not used at all during the middle of the five-year period for the bill and, unfortunately, has come back into play during the past few months.

There are three major points I'd like to make about the Price Support Program. First, it has cost far less than projected at the time the bill was passed.

Second, it did help keep the bottom from falling out in 2002 and early 2003 during a period of the lowest prices in a generation. Although I will tell you that implementation of the program could clearly have been improved, since the price got as low as $8.47/cwt in California, while Congress has mandated that the program not allow prices to fall below $9.90/cwt.

The third point I'd like to make is that this is the one farm safety net program written to allow the federal treasury to recoup its cost. The government either sells surplus dairy products back to the commercial market when prices rise or uses them for nutrition assistance programs either here or abroad. So not only are farmers supported when prices are headed down, consumers benefit when prices are headed back up as stored product comes back onto the commercial market. Nutrition assistance programs are important to everyone, and dairy farmers have historically had a great working relationship with the nutrition community on sound federal policy in that arena.

Given the fact that a new WTO agreement seems very unlikely, there is no reason the Dairy Price Support Program should not be continued. Given the history of expenditures in the current Farm Bill, the fact that the cost is recovered, and what appear to be far higher input costs for dairy farmers in the foreseeable future, the "score" on this program for the next Farm Bill should be significantly lower if the current level of $9.90/cwt remains the same.

The Milk Income Loss Contract Program, or MILC, or now "MILC-X," has far less consensus of opinion among producers in the west. Future programs of this type must be non-discriminatory, and a careful evaluation of their potential to stimulate production must be conducted and considered as policy is developed.

I'd like to move now from "MILC" to two programs that are "MIA – missing in action." The 2002 Farm Bill includes authorization and funding for the Dairy Export Incentive Program, or DEIP. The DEIP is our counter to the European Union's aggressive export subsidies that are often responsible for keeping world dairy product prices artificially low. It is fully WTO-legal, authorized and funded by Congress, and signed into law by the President.

Mr. Chairman, during that period of the lowest prices in a generation in 2002-2003 the Department released DEIP bonuses for a small amount of butter and that was all. So far, in 2006, again with very low prices and much economic pain for dairy farmers, there is nothing on DEIP. Something this Committee could do tomorrow, to help dairy farmers and rural communities nationwide, is to ask the Secretary of Agriculture to authorize some DEIP bonuses. In fact, DEIP bonuses are much less expensive to the federal treasury than either CCC product purchases or MILC payments. It is a cost effective way to provide support for producers, rural areas of the country and assistance in development of overseas markets for U.S. dairy products. DEIP bonuses pack a lot of bang for the taxpayer's buck.

It was also during that period of low prices a couple years ago that dairy farmers stepped up with the National Milk Producers Federation's Cooperatives Working Together (CWT) self-help program. This is a good example of the "hand-shake" dairy farmers are looking for from government as opposed to a handout. Issuing DEIP bonuses now would spur the development of export markets for U.S. dairy products, make CWT more effective, reduce CCC surplus purchases, and reduce the cost of MILC to the federal treasury. It might also signal to our trading partners that the U.S. is serious about its farm safety net until they're ready to return to the bargaining table and make international competition in dairy more fair.

The other program passed in the 2002 Farm Bill, but not implemented to date, is the assessment of the promotion and research checkoff on imported products. Our own government says they won't even try to implement that import checkoff because our law exempts a little over 1/100th of a percent of milk produced in this country. I suppose with the recent collapse of the trade talks, maybe the WTO really doesn't have anything better to do than worry about point-zero-one-percent of milk produced in the U.S. Still, the marketers of those imported products benefit from our farmer-funded promotion and research programs, so it's time that our government says they have to pay their fair share.

Gladly moving back now to things this Farm Bill does right, the Conservation Title includes a very import program for western dairymen. The Environmental Quality Incentives (EQIP) program has worked very well in California. Dairymen in my state especially appreciate the local control involved in approval of the cost-share contracts. We have had a very good working relationship with NRCS staff in Washington, D.C., and State Conservationist Lincoln E. Burton. Mr. Burton was especially helpful in developing ways to move funds from counties where EQIP was undersubscribed to counties where the program was oversubscribed.

On the flip side of the coin, however, is the Conservation Security Program (CSP). It seems this program suffers from the lack of local control that has made EQIP so successful; since to participate in CSP you must first be located in a primary watershed as designated by somebody in Washington, D.C.

California dairy farmers have been at the forefront in development of technologies for turning livestock waste into energy. We believe we can continue to develop as a significant energy supplier, but incentives will be required. We strongly urge you to include an aggressive Energy Title in the next Farm Bill. A key area on that front will be technology review and evaluation. There is seemingly no lack of technologies out there, but no one knows what really works and what doesn't; and farmers simply do not have the resources, let alone the time, to experiment.

Animal health programs are critical to the dairy industry. The Johne's Disease Control Program authorized in the 2002 Farm Bill has been put to good use by the dairy industry. We must, however, rely on the annual appropriations process for the funding. I urge you to authorize a reliably funded Johne's Program in the next Farm Bill.

Dairy farmers support animal identification. The development of a national ID system should continue along the lines of the USDA's five-year plan and then become a mandatory system.

I mentioned nutrition programs earlier. They have been an important feature of the Farm Bill for both producers and the public. The WIC and Food Stamp Programs provide nutrition assistance and education for our most at-risk citizens. Farmers benefit from the food requirements those programs include. The variety of foods in those programs should be increased. The best nutrition science available today suggests, however, that dairy foods not only provide many essential dietary requirements, but also play a valuable role in maintenance of proper body weight. Keeping dairy requirements in those programs fully funded is the right thing to do.

Additionally, increasing the minimum nonfat solids standards of milk on a national level, or at least matching the California standards, would not only contribute to a healthier American population, but would also contribute to a healthier American pocketbook by reducing government purchases of non-fat dry milk. In a 1993 study by Texas A&M, researchers Joe Outlaw and Ron Knudsen determined that an additional 473.9 million pounds of solids would be consumed in retail dairy products rather than going to government purchases.

A subject that comes up from time to time is forward contracting for dairy farmers. Simply put, forward contracting between farmers and private handlers is not consistent with the goals of a system that includes regulated minimum prices. If you're in favor of pooling, this type of forward contracting cannot be allowed.

While these are not Farm Bill programs, there are a few priority issues for dairy farmers right now I'd like to mention. First, dairy farmers in all parts of the country rely on immigrant labor to milk their cows. Access by farmers to a properly documented workforce is a must for everyone in this country, not just farmers. An effective guest worker program improves national security. However, a policy that forces farmers to be responsible for document verification and subject to fines or worse will make many decide that continuing to farm is simply just not worth the risk involved.

I'd like to take this opportunity to thank the Committee for its help in passing S 2120, the Milk Regulatory Equity Act of 2006. This bill has already helped level the playing field for dairy farmers in this part of the country.

Mr. Chairman, thank you again for holding this hearing and allowing me to testify. I will be happy to try to answer any questions you or other Members of the Committee may have about these issues.

Good morning, my name is Joaquin Contente. I own and operate an 850-cow dairy with my brother and family in Hanford, California. I am president of the California Farmers Union which represents more than 2500 farmers and ranchers statewide including the dairy producer members of the California Dairy Campaign (CDC). I currently serve on the board of directors of the National Farmers Union, which represents 250,000 family farm and ranch members across the United States. I greatly appreciate the opportunity to testify here today and commend the committee for its leadership in holding a hearing to consider the state of the California dairy industry.

I have been involved in the dairy industry here in California my entire life and I believe that producers today are facing the greatest challenges I have seen in my lifetime. Due to low producer prices, rising imports of concentrated dairy products, consolidation, a lack of competition and a range of other challenges, the future for many producers in this state is in jeopardy. We urge federal lawmakers to take immediate steps to improve our outlook by stabilizing producer prices, applying effective tariffs to dairy imports and taking immediate steps to make the dairy sector more competitive.

The California Milk Advisory Board (CMAB) recently completed a study titled "Foundation for a Consumer-Driven Dairy Growth Strategy" to determine how dairy producer and processors can grow the industry profitability during the next 20 years. The report states, "The strategy that worked so well over the last two decades is not likely to lead to profitable growth in the future. Farmers will probably face increased regulatory costs, lower mailbox prices and the need to provide capital to build processing plants. These factors could very well lead to a decline in overall industry profits." The report further concludes that "The advantages of the California pricing system that attracted proprietary processors in the past have eroded."

The report confirmed many of the concerns Farmers Union has held about the state of the dairy industry in California. We believe federal lawmakers should take steps to improve our outlook by stabilizing producer prices, addressing rising imports of concentrated dairy products and fostering greater competition in the dairy sector.

Improve Low Producer Prices

Prices paid to dairy producers throughout the state today are 30 percent below our cost of production and the outlook for the future is uncertain. Producer prices have reached their lowest levels in two years. A 1000 cow dairy with average costs is currently losing more than $60,000 per month or $720,000 per year.

It is difficult, if not impossible, for producers to pay their feed and other input costs when our price does not cover our cost of production. As a result, low dairy producer prices are having a ripple effect on the rest of the state agricultural economy.

At the same time that producer prices have dropped, our input costs continue to go up and up. Record high energy prices affect every stage of our dairy operations. High fuel prices increase the amount producers spend to grow or purchase feed for our cows. CDFA estimates indicate that producers are paying on average 16.4 cents per cwt in surcharges on their feed and transportation bills. Under the current system, producers are not able to recoup our higher energy costs from the market. It is the processors and retailers who have that ability, not the producers.

MAILBOX PRICES

YEAR	California	Upper Mid-West	Difference
1999	13.44	13.56	-0.12
2000	11.51	11.55	-0.04
2001	13.89	14.4	-0.51
2002	10.99	11.84	-0.85
2003	11.48	12.01	-0.53
2004	14.76	16.34	-1.58
2005	13.88	15.23	-1.35
May-06	**10.48**	**11.97**	**-1.49**

Reform the California Milk Pricing System
As you know, the 1996 farm bill provided California the opportunity to join the Federal Milk Marketing Order system, but the state chose not to join. As a result of California's refusal, the entire federal system was forced to adopt California pricing formulas, which include make-allowances with built in cost of production values for plants. In order for California to maintain market share, it reacted by adjusting its formulas to remain below the Federal Order producer prices.

According to a recent edition of the Cheese Reporter, "California's mailbox price last year was $1.47 per hundredweight below Wisconsin's. So even if it costs California 10 cents per pound to haul cheese to the Midwest, it still has a 47-cent per hundred advantage over Wisconsin."

The California pricing system is causing two things to happen. Due to the make allowance rate, price adjusters and other factors, California processors are able to sell dairy products at prices that are below prevailing market prices. California prices in turn lower the CME price upon which our producer price is based. Also due to the current formulas, California plants are continuously asking for more milk than the market is demanding.

We believe the current make allowance system overall sends a false signal to processors to continue production regardless of market demand. The current fixed make allowance system provides a strong incentive for processors to run as much raw milk as possible through a plant regardless of market conditions. The result from this system is that it puts the needs of the processor at odds with the needs of the dairy producer. Too much milk reduces the price to the dairy farmers and milk shortages decrease the amount of milk available to the processor.

We believe the make allowance system should be reformed so that it provides benefits to the producer and processor. We favor the establishment of a variable make allowance that would tie processor and producer prosperity together. A variable make allowance would increase significantly when milk prices are high, thereby giving an incentive to the processor to continue production because the return would be greater. However when milk prices are low the make allowance would decrease and send a signal to the processor to limit production in order to allow demand to catch up with production. We believe a variable make allowance is a "win-win" proposal because it would enable producers and processors to make a higher return when milk prices rise.

As long as the manufacturing allowance is fixed at the processor's cost plus a return on investment, and is paid for by farmers, the processing segment of the industry will be unconcerned with market signals. We need a system that works with the marketplace at all levels: producer, processor, wholesaler, retailer and consumer to provide an equitable, stable and viable economic environment for all segments of the dairy industry.

Recently CDFA decided to increase the manufacturing allowance, which would lower producer prices even further. The additional amount producers pay processors through the cost allowance will not benefit producers in this state because investment is going elsewhere. A recent article in Western Business Dairy stated that expansion is not likely to occur in California due to the fact that other states such as Indiana, Kansas, Ohio, Nebraska, Texas, and Wisconsin have an advantage due to their closer proximity to consumers in the Eastern portion of the U.S. As well these states are favorable for expansion due to lower feed and other cost inputs including labor. Seventy-seven percent of the U.S. population lives outside of the Western States and processors and well as producers are leaving California to service that larger market with less expense.

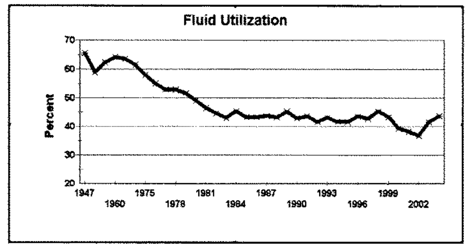
Improve agricultural trade policies

In 1995, the U.S. became a net-importer of dairy products for the first time as a result of the dramatic changes to federal dairy policy. The balance of trade for U.S. dairy products in 2004 totaled $1,452,904,000 in exports and $2,330,709,000 in imports. Today, due to politically motivated domestic dairy policies, the U.S. imports approximately 10 percent of its consumption needs. The imports consist primarily of proteins, cheese and butter. The U.S. exports a significant amount of lower valued lactose, as a result of being the world's largest cheese producer.

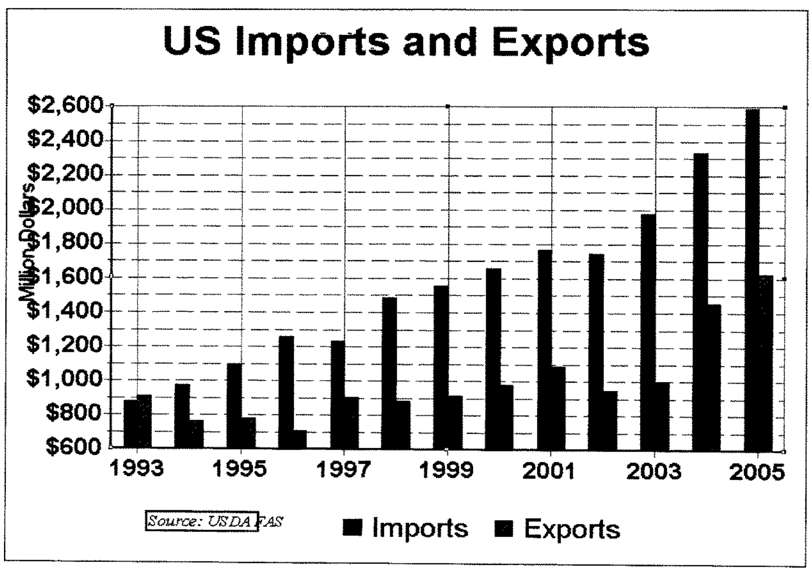
Milk Equivalent (Billion Lbs.)	Factor	2001	2002	2003	2004	2005
CHEESE	x10	4.45	4.75	4.75	4.71	4.60
CASEIN	x39	8.58	7.93	8.94	8.72	8.36
BUTTER	x4.2	0.32	0.14	0.13	0.22	0.16
MPC	x22	1.72	2.01	2.34	2.12	2.67
LACTOSE	x5.5	0.06	0.05	0.08	0.06	0.06
TOTAL		15.13	14.88	16.24	15.84	15.85
U.S. MILK PRODUCTION	(Billion)	165.336	169.758	170.394	170.934	176.989
PERCENT OF U.S. PRODUCTION		9.15%	8.77%	9.53%	9.27%	8.95%

UNITED STATES DEPARTMENT OF AGRICULTURE FAS AGRICULTURAL IMPORT COMMODITY AGGREGATIONS

When the U.S. became a net importer of dairy products it caused a new era of tremendous volatility in the dairy market. Previously, the U.S. had not experienced the degree of instability unless the supply came in close relationship to the demand. After the parity system was eliminated in the early 1980's, the U.S. still had ample production for all domestic consumption needs and world market demands. The lower support prices, coupled with ample supply caused producer prices to plummet. The next decade can be best described as the "Wild Roller Coaster of Producer Prices". Prices during some months would leap to \$16 - \$17 - \$18 or even \$20 per cwt, yet within a matter of weeks there would be a \$6 per cwt drop! This volatility has shifted most of the risk to the producers, making it difficult to budget or plan.



Another factor in the "Wild Roller Coaster" is the amount of milk protein imports penetrating our borders without tariffs. This loophole, which allows caseins, caseinates and milk protein concentrate, duty free access was an oversight by U.S. negotiators at the Uruguay Round. Importers have also avoided tariffs on skim milk powder by blending casein with skim powder and calling it milk protein concentrate.



Foster Competition in the Dairy Sector

Unfortunately, consolidation within the agricultural industry has increased in recent years and has brought about the demise of thousands of family-run farms. Independent producers are finding it increasingly difficult to participate in a fair, open and competitive market. The consolidation trend has spread beyond the farm gate and now threatens independent retailers. Since 1999, National Farmers Union has commissioned a series of studies by the University of Missouri-Columbia Department of Rural Sociology to gauge concentration in agricultural and retail markets. The latest update, released in February 2005, reveals that the top four firms in most agricultural sectors have tightened their strong-hold since the 2002 study.

FOOD RETAILING **CR5 = 46%***

Supermarket	Grocery Sales*
1. Wal-Mart Sores	$66.465 Billion
2. Kroger Co.	46.315 Billion
3. Albertsons, Inc.	31.962 Billion
4. Safeway, Inc.	29.572 Billion
5. Ahold USA, Inc.	25.105 Billion

Source: * *Progressive Grocer's Super 50* (5/1/04)

Due to increased levels of concentration and consolidation, there is a lack of competition in the dairy sector in the U.S. A few major companies dominate the market, leaving producers and consumers to suffer as a result. In order for the dairy industry to be viable and sustainable in the future, policy decision-makers need to take immediate steps to foster and restore competition in the marketplace.

DAIRY PROCESSORS

	Annual Sales *
1. Dean Foods	$8,260 Million
2. Kraft Foods (Majority owner is Philip Morris)	$4,300 Million
3. Land O'Lakes	$2,969 Million
4. Schreiber Foods, Inc.	$2,200 Million

*Source: *Dairy Foods: Dairy 100 (2004)*

The United States is the worlds' largest market for dairy products today. However, we are second to India in total milk production. The approximate value of the nearly 170 billion pounds of U.S. milk produced for 2004 was $27 billion dollars at the farm level. The top producing states include California (21%), Wisconsin (13%), New York (7%), Pennsylvania (6%) and Idaho (5%). Cooperatives in the U.S. handle over 80% of the total milk production. However, not all cooperatives actually process their members' milk; some only market the milk collectively for their members.

During the past two decades, annual U.S. per capita sales of fluid milk has fallen steadily from year to year; 233.76 pounds (1980) to less than 185.9 pounds (2003). During this same time U.S.

per capita consumption of selected dairy products (fluid milk, cream, butter, frozen dairy and cheese) rose steadily; from 541 pounds (1980) to 594 pounds (2003). Annual U.S. per capita consumption of milk has declined from yearly since 1970. However, the consumption of cheese has virtually doubled over the last 20 years, from roughly 15 to 30 pounds.

Chicago Mercantile Exchange (CME) Reforms

The Chicago Mercantile Exchange (CME) sets the price dairy farmers receive for their milk, despite the fact that a very small percentage of dairy products are traded on the market. Dairy producers across the country are very concerned that the lack of federal oversight and transparency at the CME has led to market manipulation, which may be resulting in a highly volatile market, negatively impacting producers.

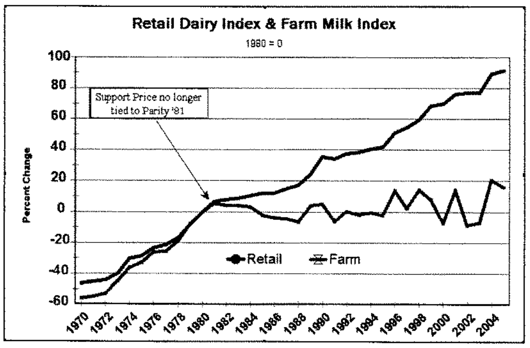
Historically, the CME trades an average of 20-25 loads of block cheese per week. However, USDA's Dairy Market News reports that for a period of 80 days this spring, only 26 loads of block cheese moved on the market -- despite an alleged surplus of cheese across the country. If a surplus of cheese does exist, why is the CME only trading 26 loads in 80 days? Due to the lack of transparency at the CME, producers that may be economically impacted by anti-competitive trading practices, have no recourse to independently inquire or investigate the lack of competition in the marketplace. If the CME was a more open and honest market, more businesses would trade and increase the volume to create a more accurate and reliable market that better reflects the actual milk production in the United States. We call upon federal lawmakers to take immediate action to investigate the alleged anti-competitive trading practices of the CME.

One of the greatest challenges facing U.S. producers and every other producer in the world is consolidation and concentration of the marketplace, which also drives market globalization. Capitalistic markets function properly when there is a balance of buyers and sellers. There are about 60,000 dairy farms marketing milk today through 200 cooperatives. Half a century ago, there were 180,000 dairy producers marketing through 1,000 cooperatives. While the number of farms and cooperatives continue to decline, the marketing presence of farmer-owned dairy cooperatives has actually expanded during the past generation. Despite this expansion there is less competition vying for producers at the co-op level, with more intervention by non-cooperatives and non-farmer controlled businesses.

Dairy cooperatives continue to grow in size and form strategic alliances with private entities. For example, my own cooperative, Land O' Lakes, sells a large portion of their cheese to Kraft Foods. The largest cooperative, Dairy Farmers of America, has ongoing agreements to supply milk to Dean Foods and Leprino Foods, and continues to expand its relationship with Fonterra. Cooperatives justify their actions by claiming they are subject to the growing demands of retailers. Wal-Mart, for example, wishes to consider no more than two suppliers for each food product it features in its stores across the U.S. The consolidation and concentration not only harm producers through lower prices, but also negatively impacts consumers with less choice at the grocery store.

In most U.S. metropolitan areas, one company, Dean Foods, has acquired the majority of fluid plants. Two corporations dominate the cheese sector; Kraft Foods at the retail level and Leprino

Foods at the food service level. Regardless of which cooperative a U.S. producer markets his milk, at the end of the day the vast majority of milk is purchased by only three major buyers that dictate each market. Dean Foods dominates the fluid market, Kraft owns the retail market and Leprino runs the food service market. Until steps can be taken to end the stranglehold that these three entities have on the three major components of the dairy sector, competition will be stifled and producer prices depressed.



Economic power concentrated in the hands of a few players has essentially eliminated the price system, which capitalism is thought to rest. The farm-gate price is no longer cost plus profit; instead it is a command economy with a few corporate players dictating farm price. The loss of producer economic power is best illustrated by the widening gap between retail prices and farm-gate prices. While consumers continue to experience sticker-shock on dairy products, dairy producers are left with a shrinking percentage of the consumer dollar.

Solutions

To improve producer prices we call upon Congress to pass legislation to establish a $12.50 dairy support purchase price that is funded through a producer assessment.

We recognize the potential cost of a higher support price to the federal budget. In order to address this concern, we support legislation to authorize the U.S. Department of Agriculture (USDA) to establish a producer assessment program to fund the increase in the support purchase price. In order have no cost to the federal budget; the $12.50 support price would be funded through an assessment on dairies that expand their operations beyond prevailing market demand. The first 2.4 million pounds of milk produced on dairy farms would be exempt from the assessment in order to foster entry level producers and sustain smaller dairy operations.

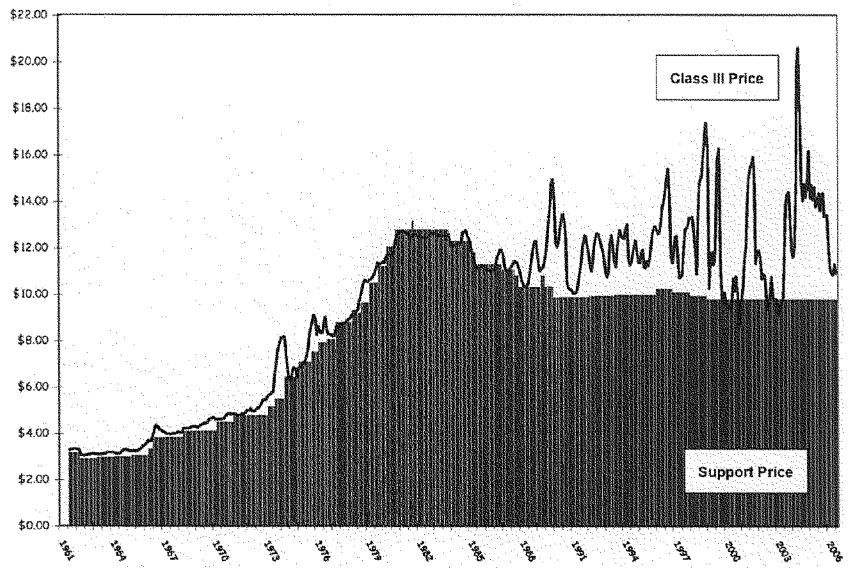
Although the $12.50 support price is still below the average cost of production, the higher purchase price would provide a more meaningful level of support to producers. Furthermore, the assessment program would create an effective incentive to ensure dairy production is in line with market demand.

Dairy markets have become captive entities to a few consolidated retailers and marketers in our industry. According to USDA, domestic consumption increases at a rate of over 2 percent per year. Producers increased production from 2002 to 2005 at a rate of less than 1 percent per year. In March 2004, the CCC purchased 3 million pounds of milk equivalent. Since December 2004, CCC purchases have been virtually nonexistent since then with no CCC purchases in 2005 and only a minimal amount thus far in 2006. A lack of competition is also preventing consumers from benefiting from lower producer prices. Many dairy products today contain imported milk protein concentrate (MPC), casein, caseinates and other ingredients that displace high quality and nutritious US produced milk. Due to the lack of competition in the marketplace, we believe producers lack the market power to receive the true value of their milk.

We call upon federal lawmakers to pass the "Milk Regulatory Equity Act," to apply effective tariffs to imports of milk protein concentrate (MPC), casein and caseinates. We call upon federal lawmakers to investigate the alleged anti-competitive trading practices of the CME and take other steps to foster a more competitive marketplace.

We believe the solutions we outlined today will go a long way toward improving the future for dairy producers throughout California. We again thank you for the opportunity to testify here today and look forward to continuing to work with members of the committee on issues affecting farmers and ranchers.

Class III Price and Support Price
August 1961 - August 2006
(Dollars Per Cwt.)



Prepared By: Upper Midwest Federal Milk Order, Minneapolis, Minnesota

Last updated on: 9/1/2006

STATEMENT OF SUE TAYLOR

Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today. My name is Sue Taylor and I am Vice President of Dairy Policy and Procurement at Leprino Foods. Leprino Foods is a family-owned company that has grown from making small batches of ricotta and mozzarella cheese for local delivery to the world's largest producer of mozzarella cheese. We operate nine plants in the United States, manufacturing mozzarella cheese and whey products. Six of the nine plants receive milk pooled in the Federal Milk Marketing Orders administered by USDA. We operate three manufacturing facilities that are regulated under the California state order.

Before discussing issues related to the next farm bill, I would like to thank members of the Committee for passing the Milk Regulatory Equity Act (”MREA”) earlier this year. It was a critical piece of legislation and we appreciate your efforts.

In an effort to prepare the dairy industry for future competitiveness here and abroad as part of the next farm bill, we suggest Congress:

1. mandate that USDA act with speed in its regulation of the Federal Milk Marketing Orders to keep up with changes in the dairy marketplace,
2. give all producers and processors risk management tools like forward contracting, and
3. resolve the conflicting nature of the two existing Federal dairy safety nets.

Make Allowance and Streamlining the Federal Milk Marketing Orders. First, I want to thank the Chairman for his support of updating the make allowance to allow the milk pricing formulas of the Federal Milk Marketing Order to reflect current manufacturing costs. I have just returned from the USDA hearing on the make allowance and I hope the Department will act quickly on the hearing record and finalize the formula update within weeks and not months.

The delay and politization of the make allowance update is of great concern to Leprino and other dairy manufacturers across the country. The make allowances in the current formula are based upon cost data from the late nineties. With the significant rise in energy, healthcare and other costs since the late nineties, the industry was closing in on a financial crisis by 2005. Going to the marketplace to recover the increased costs is not an option. The make allowance hearing was requested and granted on an “emergency” basis last year. A four-day hearing was held last January and yet, here we sit with no decision from USDA some nine months later. A year of deliberation is simply not acceptable when the industry is losing millions of dollars a month. Mr. Chairman, I hope you will continue to urge USDA to finish what they started and not be distracted by calls to link this simple, straightforward exercise with other proposals that are unrelated to the pricing of milk for manufacturing.

Congress should urge USDA to take a page from the playbook here in California. The California state milk marketing order also has hard and fast deadlines for considering and making changes to its state order. Changes are implemented within 60 days after concluding its public hearing, as required by law. This system has allowed California processors and producers to be more responsive to commercial demands while the rest of the Nation lingers under the cumbersome bureaucracy of USDA.

Reinstating the Right to Forward Contract. Price volatility has become an increasing concern to domestic and international customers alike. I believe that the ability to forward price significant volumes of product is key to driving demand for American dairy products. Unfortunately, multiple food service customers have told me that they are frustrated by price volatility over the years and, as a consequence, are minimizing the use of cheese in menu items. Neither producers nor processors win when our ultimate consumers turn away from our product because of volatile prices. Leprino routinely uses the risk management tools available to offer forward prices to our customers, but futures market liquidity on the Chicago Mercantile Exchange where dairy is traded still makes accumulation of significant volumes cumbersome. Congress can help address this need by reinstating the dairy forward contracting program.

In addition to the demand issues that will be addressed by forward contracting, I can tell you as a former agricultural banker with continued ties to that community, forward contracting is an important tool in the producer arsenal.

Reforming Current Federal Safety Nets. Finally, I would like to briefly comment on the current Federal safety nets. Leprino is very concerned that the Milk Income Loss Contract Program (MILC) impedes the industry's transition to becoming a more competitive long-term player. The program's current structure with a very high target price and limitations on eligible production shields smaller producers from market forces, resulting in greater production and lower overall market prices.

At the same time, mid-sized and larger producers are primarily gaining their revenue from the depressed markets, placing these more efficient producers that represent the future of our industry under financial stress. The MILC program runs headlong against the U.S. industry's need to become more competitive. Moreover, the current dairy price support program is not operating as intended.

The dairy price support program has also become more disruptive to the marketplace. For example, the accumulation of over a billion pounds of nonfat in USDA's coffers a few years back was very disruptive. Given limitations on distributions for international food aid, USDA started giving away surplus milk powder accumulated through the dairy price support program for livestock feed in drought areas. The more powder that came out of government storage, the more prices in the free enterprise whey market were undermined. Leprino's whey and cheese business is hurt when the government is buying product and dumping it on the marketplace when it is not needed.

Leprino is operating under the laws of supply and demand but the current dairy programs with these two conflicting safety nets are not. The price support program and the MILC program work against one another and stifle innovation and growth in the dairy industry.

Today, in dairy we have a Federal pricing scheme that is complex and unresponsive to markets. We have to deal with greater volatility and production of unwanted, surplus products. This web of programs combines to put the U.S. dairy industry farther behind our competition.

However, with your help in modernizing these dairy policies, we will have a greater opportunity to expand domestically and earn a greater share of international markets. We need Federal dairy policies that help pave the way, rather than impede our progress to flourish in the long-term.