

Written Comments Submitted by:

Edward W. Gallagher

Vice President, Economics and Risk Management

Dairylea Cooperative Inc.

On behalf of the:

Greater Northeast Milk Marketing Agency

Before the:

Pennsylvania Senate

Committee on Agriculture and Rural Affairs

December 9, 2009

Harrisburg, PA

Good afternoon. My name is Edward Gallagher. I am the Vice President of Economics and Risk Management at Dairylea Cooperative Inc. and Dairy Marketing Services. My Curriculum Vitae is attached as Exhibit 1.

Thank you for inviting me to testify today on behalf of the cooperatives conducting business in Pennsylvania. Today, I am testifying on behalf of the Greater Northeast Milk Marketing Agency cooperatives that market milk in Pennsylvania. These cooperatives are: Dairylea Cooperative Inc, Dairy Farmers of America, Land O'Lakes, Maryland and Virginia Milk Producers Cooperative Association, Inc. and Upstate-Niagara Cooperative, Inc.

We sit here at the end of the worst financial crisis our members and all dairy farmers have ever faced. Since February of this year, most U.S. dairy farmers have operated at significant financial losses. Recently, the efforts of the nation's leading dairy cooperatives, including those I am representing today, through the Cooperative's Working Together Program or CWT, have helped to reduce the nation's milk supply and spur the price recovery. At the same time, improved economic performance here in the US and around the world has helped to again grow worldwide demand for dairy products. As this has occurred we are seeing improvements in milk prices. My projections show a gross milk price of \$17-plus for milk produced in Lancaster County Pennsylvania in December 2009. This is almost \$5 per hundredweight (cwt) more than prices received at the beginning of the summer. It would also be about \$1 per cwt higher than the price received in December 2008.

Despite the higher prices, dairy farmers have a long way to go before they are back to even. It will take an extended period of even stronger milk prices for dairy farmers to pay back the losses they incurred this year.

Recently, I had the honor of testifying before a US Senate Agriculture Subcommittee hearing co-chaired by Senator Casey. An attachment contains that testimony. I do not intend to read the attachment but submit it for your information. It describes a

number of activities that have been undertaken to improve the financial well being of our members and further explains the reasons for the milk price crisis. I encourage you to read this information.

I want to focus the remainder of my time today on providing some information about the trail of money from retail to farm and to suggest some options to consider that could lead to an improved the economic environment for the Commonwealth's dairy farmers.

Farm-to-Retail Price Spread Information

The following is provided as a means of helping explain where the milk check dollars are consumed. I have utilized Federal Order No. 1 data from their Mailbox Milk Price series. Recently they began publishing average hauling deductions and over-order premium payments, by region, as reported in handlers' payrolls. The region that I am using as my example is Eastern Pennsylvania.

The publishing of the Market Administrator data allows a fairly accurate presentation of the information in Exhibit 2. The Gross Milk Price that I report is \$13.17, which compares to the USDA, NASS All-Milk Price of \$13.30, for the entire state. My estimate of the Value of Additional Components is in line with the PA butterfat test average reported by USDA, NASS (3.60%), reported by Federal Order No. 1 in their price announcement (3.61%) and the component prices for August.¹ The CWT Investment and the Cooperative Dues and Equity are my best estimates of how the charges showing up on cooperative member checks impact the calculation.² The M.A. assessment is my estimate, as well. This is the fee that non-members pay to the M.A. for market information, component test auditing and bulk tank calibration.

¹ The Value of Additional Components is the value above the 3.5% butterfat, 2.99% protein and 5.69% other solids standards for reporting Federal marketing order prices.

² Since the CWT investment is \$.10 per cwt of member milk, I am estimating that 60% of the milk in Eastern Pennsylvania contributes to CWT making the average for all the milk in Eastern Pennsylvania \$.06 per cwt. This same logic follows through on dues and equity.

Exhibit 2 indicates that, on average, a gross milk price of \$13.17 per cwt was generated in payments back to farms for their sales of milk. The gross price was based on Class I, or beverage milk, that brought about \$15.00 per cwt to dairy farmers³, Class II, or yogurt, ice cream and candy production, among other products, that brought about \$11 per cwt to dairy farmers, Class III, or cheese, that brought about \$12 per cwt, and Class IV, or butter and powder, that brought about \$10 to dairy farmers. All of these Class prices are my estimation of marketing order minimum prices plus over-order premiums. Likely, a margin of error of plus or minus \$.50 per cwt exists for each of the Classes. Although not precise values, this portrayal gives you a sense of the values dairy farmers receive. For instance, the Class III price of about \$12 per cwt is representative of a cheese price of about \$1.35 to \$1.40 per pound.

As can be seen in Exhibit 2, there are about \$1.05 per cwt in marketing costs deducted from milk checks. The largest is Milk Hauling, which is competitively determined in the market place. The second largest deduction is Milk Promotion which is mandated under Federal and state laws.

The remaining \$12.12 per cwt, on average, was left in dairy farmer milk checks to pay their business costs and repay loans.

Exhibit 3 and 4 are my attempts to show how much of the PMMB minimum retail price is captured by dairy farmers, retailers and wholesalers. I used August 2009 for comparison with the mailbox price example and also provided an example of the values that will be captured in December 2009.

The producer values of \$1.34 and \$1.72 per gallon, respectively, are dollars that are included in dairy farmer milk checks. Since these are Class I values, these dollars show up in the Federal Order blend price and in over-order premiums.

³ This value is less than the PMMB Class I price. A large amount of Pennsylvania produced milk is delivered to Class I plants located in New Jersey, Maryland and other states or is sold by PA plants into those states. The \$15 is my estimation of the PMMB Class I and non PMMB Class I values that would generate revenue to pay Eastern Pennsylvania dairy farmers during August.

Exhibit 5 is a document entitled "Dividing the Retail Dollar". It was developed in 2006 by my staff at DairyIdea. It is a portrayal of the farm-to-retail spread in New York. As can be seen, around 47 percent of the retail price is paid to dairy farmers via the Class I price (which includes over-order premiums). This is a similar percentage as shown in Exhibits 3 and 4.

Stranded Producer Dollars

The Pennsylvania Milk Marketing Board regulation generates a Class I over-order premium that finds its way back to Pennsylvania dairy farms if the following three parameters are met. First, the milk is produced on a farm in Pennsylvania. Second, the milk is sold to a Class I dealer in Pennsylvania. Third, after meeting the first two conditions, the milk is sold at retail in Pennsylvania. I have unofficial data that suggests that about 1.5 billion pounds of Pennsylvania producer milk received the Board's Class I over-order premium during 2008. However, those Pennsylvania Class I dealers sold more than 2 billion pounds of Class I milk to retailers in the Commonwealth. Additionally, we know that Pennsylvania retailers buy milk from milk dealers that are located in other states. Working on the premise that all PA sales are sold at Board minimum retail prices suggests there are more Board mandated over-order premium dollars captured in the wholesale to retail channel, than are paid to dairy farmers. We believe there needs to be a process of capturing these "stranded producer dollars" and distributing them pro-rata, based on production volumes, to all Pennsylvania dairy farmers.⁴

I do want to make note of the method of distributing the stranded producer dollars. We insist that these dollars be shared among all Pennsylvania dairy farmers, not just

⁴ We are not suggesting that the stranded producer dollars are equal to the over-order premium plus the over price premium times the difference between the cwt's of PA retail sales and producer volumes receiving the current premiums. Most, if not all, of the milk showing up on PA retail shelves had some level of Class I over-order premium invoiced on the sale to the milk plant. However, with the higher PMMB over-order premium level (\$3.52 per cwt for December), there is likely a large difference between the PMMB farm priced milk and the non-PMMB farm priced milk. It is that difference in price that is stranded in the wholesale to retail channel that should be paid to PA dairy farmers.

those few farms receiving the benefits of the Board's over-order pricing initiatives.⁵ We strongly believe that milk prices in excess of those occurring in the absence of the regulation, should be shared equally by all producers. The stranded producer dollars, by definition, are dollars that exist because of the regulation, and not a farmer's, cooperative's or other entities savvy in marketing and price negotiation. We also believe this same concept needs to be applied to the current distribution of the Board's Class I over-order premium dollars that it currently captures on behalf of dairy farmers.

Innovative Pricing Program

Over the last few years, the Cooperatives have allocated significant resources in attempts to innovatively utilize the milk marketing laws in Pennsylvania and other Northeastern states. The goal of the project is to help generate stronger Class I prices on all Pennsylvania produced milk delivered to Class I plants. This has the potential to generate higher Class I premiums on milk delivered to PA Class I plants, but distributed on routes outside of PA, and on PA produced milk delivered to out of state Class I plants. For this to occur, the PMMB needs to take the important step of pricing producer milk where purchased. We believe the Board's action in this regard will foster higher over-order premiums for Pennsylvania producers.

Risk Management Education

Lastly, I want to commend the Pennsylvania Center for Dairy Excellence, the Department of Agriculture and numerous agri-businesses, for embracing milk price and milk over feed margin risk management programs. Milk and feed price volatility will continue and may get worse. It is imperative that PA dairy farmers learn the benefits of using these risk management tools to protect their incomes from disastrous declines – like those that happened this year. I operate the milk price forward contracting programs for DairyLea and DFA. Our forward contracts paid members using them, significantly more

⁵ PA dairy farmers produce about 10.5 billion pounds of milk, annually. About 1.5 billion pounds generates PMMB over-order premium dollars. This amounts to about 14 percent of Pennsylvania production.

revenue than the market generated. In some cases, our members received Class III milk prices in excess of \$16 per cwt for the entire year. At times, this was more than \$6 per cwt above the market price. These programs work to protect farmers against severe income declines. Your support and encouragement of efforts to help dairy farmers understand the benefits of using these tools will have tremendous benefits to your dairy farmer constituents in years to come.

Thank you for allowing me to testify before you today and I look forward to your questions and a continued dialogue with you on these subjects.

Exhibit 1

Curriculum Vitae

Edward W. Gallagher
Vice President, Economics and Risk Management
Dairylea Cooperative Inc.
5001 Brittonfield Parkway
Syracuse, NY 13221
315-433-0100 (tele.)
315-433-2345 (fax)

Professional Experience

- Dairylea Cooperative Inc., 1996-present
 - Dairylea is a milk marketing and member services cooperative located in Syracuse, NY. It is the 5th largest US dairy cooperative.
 - Vice-President, member of senior management team, 1999 - present
 - Manage Dairylea's Risk Management Services business, 1998-present
 - Developed the industry's most innovative milk price forward contracting programs
 - Developing multi-year milk price contracts adjusted for changes to input prices
 - Assist in the management of DFA's risk management business, 2006 - present
 - Dairylea is a member cooperative of DFA
 - Director, Regulatory and Government Affairs, 1996 - 1999
- Dairy Marketing Services, Vice President 1999-present
 - Dairy Marketing Services is a milk marketing joint venture between Dairylea, DFA's Northeastern Area Council and St. Albans Cooperative.
- Federal Order No. 2 Market Administrator's Office, 1983-1996
 - Chief of Market Analysis, Research and Information, 1991-1996
 - Agricultural Economist, 1987-1991
 - Cooperative Relations Specialist, 1984-1987
 - Researcher, 1983-1984
- Worker/Manger Gallagher Family Dairy Farm, Sangefield, NY, through 1984
- Cooperative Extension Summer Intern, 1983

Milk Hearing Expert Witness Experience

- Numerous Pennsylvania Milk Marketing Board Hearings
- 4 Federal Order Hearings
- 2 Congressional Hearings
- Pennsylvania Joint House/Senate Milk Marketing Board Hearing

- Numerous Federal Order Reform Public Meetings
- Numerous Northeast Dairy Compact Hearings
- New Jersey State Dairy Pricing Hearings

Organization Memberships

- National Milk Producers Federation
 - Member, Federal Order Task Force
 - Member, Price Insurance Task Force
 - Alternate Delegate
- Northeast Dairy Farmer Cooperatives, Board Member
 - NDFC is a governmental affairs advocacy groups made up of Dairylea, DFA, St. Albans, Agri-Mark and Upstate-Niagara Cooperatives
- Greater Northeast Milk Marketing Agency
 - GNEMMA is an agency-in-common among the 7 largest northeastern US dairy cooperatives to work together on Federal and state marketing order and milk pricing issues
 - Member, Economics Committee
 - Member, Government Affairs Committee
- Member, 21st Century Dairy Club
 - 21st CDC is a private group made up of 30 dairy farmers and 25 agri-businesses that meets to discuss the advancement of the dairy industry
- Eagle/Dairy Direct, Board Member
 - E/DD is Dairylea's input buying business that assists dairy farmers in bulk-buying to receive discounted prices on most inputs used on dairy farms
- Member, New York State Milk Marketing Advisory Council
- Cornell University's National Dairy Economist Group
- New York Agricultural Society
- Member, Senator Kirsten Gillibrand's Agricultural Advisory Group
- Former Member, Former Senator Hillary Clinton's Agricultural Advisory Group

Academics

- The Ohio State University, MS degree, Agricultural Economics, 1989
 - Phi Kappa Phi Fraternity
 - Masters Thesis: Cost of Hauling Milk from Farms to Plants in the Greater Ohio Area
 - Ohio Extension Research Bulletin: Cost of Hauling Milk from Farms to Plants in the Greater Ohio Area
 - Research paper selected for presentation at the annual meeting of the American Agricultural Economics Association, 1990, Vancouver, BC
- Cornell University, BS degree, Farm Management and Agricultural Economics, 1984
 - Deans List
 - Alpha Zeta Fraternity
 - Farm Credit Fellow
 - Cooperative Extension Fellow

Exhibit 2

Eastern Pennsylvania Milk Price and Marketing Deduction Information August 2009

<u>Category</u>	<u>\$/cwt</u>
Blend Price @ 3.5% butterfat	\$ 12.19
Value of Additional Components***	\$ 0.10
Over-Order Premiums*	\$ 0.88
Gross Milk Price**	\$ 13.17
Milk Hauling*	\$ (0.76)
Milk Promotion	\$ (0.15)
CWT Investment***	\$ (0.06)
Cooperative Dues and Equity***	\$ (0.06)
M.A. Assessment***	\$ (0.02)
Total Marketing Deductions	\$ (1.05)
Mailbox Milk Price*	\$ 12.12

* Published by Federal Order No. 1 Market Administrator's Office.

** USDA, NASS reported a statewide all-milk price of \$13.30.

*** Estimated by Edward Gallagher.

Exhibit 3

Pennsylvania Minimum Milk Prices, PMMB Area 4 (Including Lancaster County), August 2009

	<u>\$/cwt*</u>	<u>\$/gallon**</u>	<u>% of Retail</u>
PMMB Minimum Retail		\$ 3.12	
PMMB Over-Order Premium	\$ 2.53	\$ 0.21	
PMMB Over-Price Premium	\$ 0.46	\$ 0.04	
Federal Order Class I Differential	\$ 2.90	\$ 0.25	
Federal Order Class I Mover	<u>\$ 10.04</u>	<u>\$ 0.84</u>	
Producer Value	\$ 15.93	\$ 1.34	43%
Farm-Retail Spread		\$ 1.78	57%

* Milk testing 3.5% butterfat.

** Homogenized whole milk testing under 4.0% butterfat.

Exhibit 4

Pennsylvania Minimum Milk Prices, PMMB Area 4 (Including Lancaster County), December 2009

	<u>\$/cwt*</u>	<u>\$/gallon**</u>	<u>% of Retail</u>
PMMB Minimum Retail		\$ 3.53	
PMMB Over-Order Premium	\$ 3.06	\$ 0.26	
PMMB Over-Price Premium	\$ 0.46	\$ 0.04	
Federal Order Class I Differential	\$ 2.90	\$ 0.25	
Federal Order Class I Mover	<u>\$ 13.99</u>	<u>\$ 1.17</u>	
Producer Value	\$ 20.41	\$ 1.72	49%
Farm-Retail Spread		\$ 1.81	51%

* Milk testing 3.5% butterfat.

** Homogenized whole milk testing under 4.0% butterfat.

DIVIDING THE RETAIL DOLLAR

October 2006

Fluid milk, like many commodities, returns a lower price to the farmer on a per unit basis than what the consumer pays at the store.

To discover the components of the retail price for milk, one must identify all the costs associated with producing, transporting, processing, packaging, handling, and marketing milk. In addition to actual costs, profit margins must be taken into consideration.

From the retail price of fluid milk, the actual cost of the milk must be considered (Federal Order Class I price plus over order charges). Additionally the processing plant costs must also be considered. After accounting for the Class I price and the processing costs, what is left is a margin that is paid to the wholesaler and/or retailer depending on the store's supply chain.

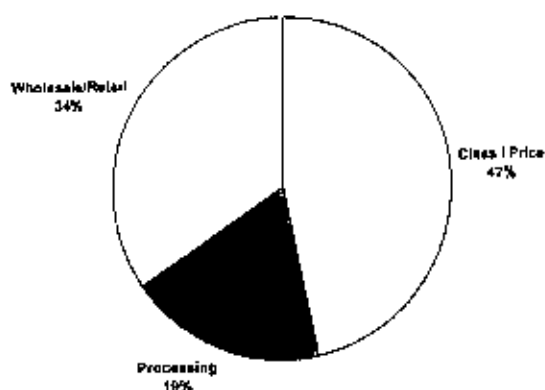
2006 YTD	Price (\$/cwt)	Percent
Retail Price*	35.37	100%
Class I Price (NYC)	16.52	47%
Processing Costs	6.69	19%
Retail/Wholesale Margin	\$12.16	34%

* Based on average retail price of \$3.04 per gallon of whole milk 2006 YTD in New York City, according to NY State Department of Agriculture and Markets.

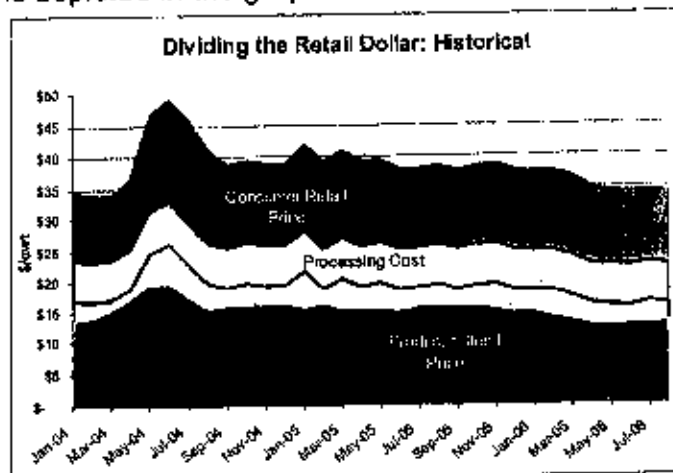
For 2006 year-to-date, the actual cost of the fluid milk accounted for 47% of the ultimate price paid by the consumer. Processing, packaging and delivery costs to the store made up 19% of the retail price, leaving 34% for wholesale and retail margins. The wholesale and retail margin has been relatively consistent in recent years, with 33% of the consumer price going to the retail and wholesale price margin in both 2004 and 2005. This is largely a measure of New York's price threshold law.

In New York, the Consumer retail price has historically been closely related to the Class I price (price paid for the milk by the fluid processor), such that the Class I and retail price increase and decrease simultaneously. Although the Class I price is highly related to the retail price, the producer blend price (price received by the farmer) deviates

Dividing the Retail \$ in NYC: 2006 YTD



more from the retail fluid price. The variation is due to the influence of non-fluid dairy product prices on the producer blend price. The blend price is a combination of all dairy products produced each month, not just the fluid price. Since the price of non-fluid dairy products are typically lower than the fluid price, the producer blend price is naturally lower than the Class I price. The relationship between the prices is depicted in the graph below:



Dairylea recognizes that a sizable margin exists between the cost to produce and process the milk, and the final price that the consumer pays. Among the various pricing initiatives, Dairylea is also working to better understand and increase its portion of the retail dollar. By working with other cooperatives, Dairylea hopes to establish pricing standards that will increase the percent of the retail dollar that is returned to the producer and ultimately increase the producer pay price.

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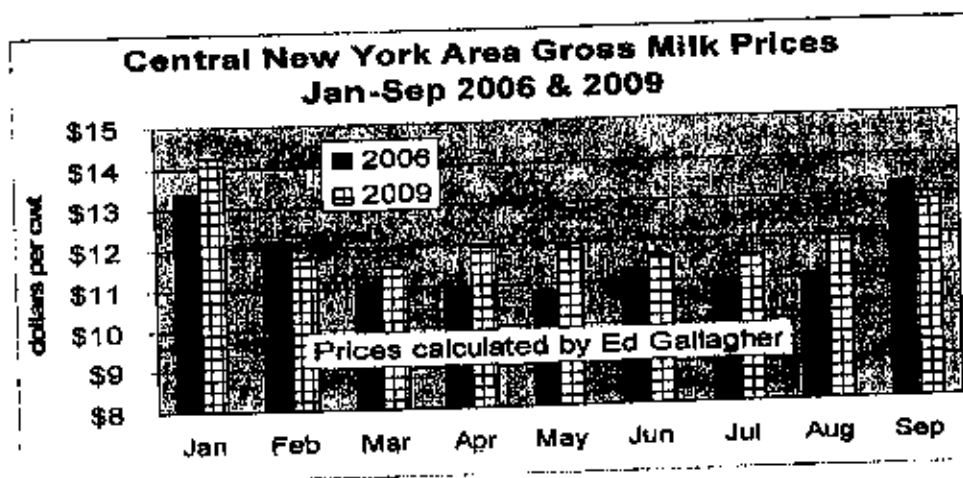
Committee on Agriculture, Nutrition and Forestry

October 27, 2009

Washington, DC

This testimony is submitted by Edward Gallagher, Vice President of Economics and Risk Management, on behalf of Dairylea Cooperative Inc. My business address is 5001 Brittonfield Parkway, Syracuse, NY. Dairylea has the largest membership of New York dairy farmers of any other dairy cooperative, and, according to *Hoard's Dairyman*, is the 5th largest US dairy cooperative. We have approximately 2,200 members in six northeastern US states.

Dairy farmers have been suffering through the worst cost-price squeeze in recent memory, perhaps in history. Prior to this down turn, one of the worst cost-price squeezes occurred during 2006. Milk prices this year, are about the same as they were in 2006, however, the financial conditions on dairy farms in New York and across the country is far worse.



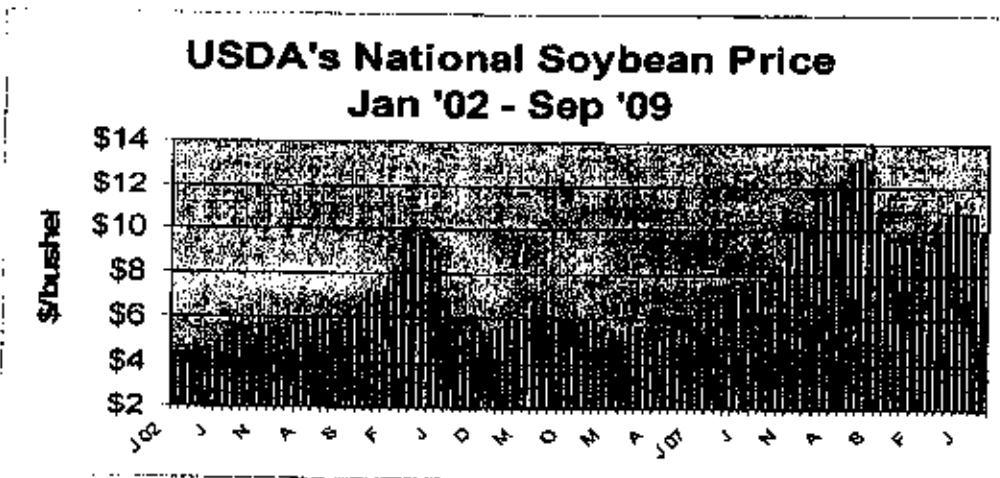
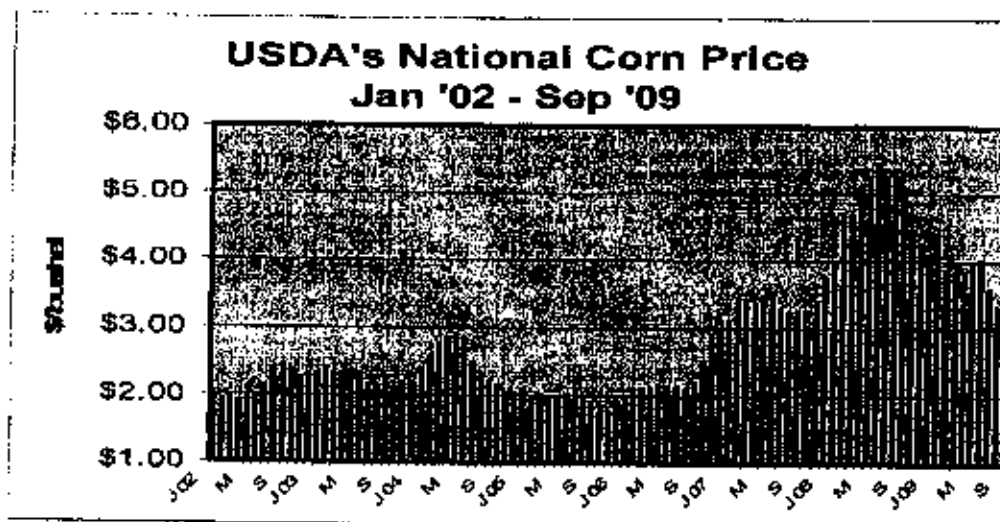
The situation is far worse due to the increased demand for corn-based ethanol and its impact on livestock feed prices.

In 2006, the US had not significantly ramped up its ethanol production. In 2005, the US produced just short of four billion gallons¹. Today, we are the world's largest producer of ethanol at 9 billion gallons – more than double the level from a few years ago. All farms purchase some feed. In New York, as it is across the country, the single biggest cost factor in producing milk is purchased feed. About one-third of the cost of producing a hundred pounds of milk is due to purchased feed. As you move across the country, that percentage will be larger. For many western US farms, the percentage is 50 percent or more.

As ethanol demanded more corn ground, it came at the expense of acreage to grow other feedstuffs – increasing their prices as well. Today, corn is priced in the \$3 to \$4 per bushel range. In 2006, it was closer to \$2 per bushel. The spillover to other

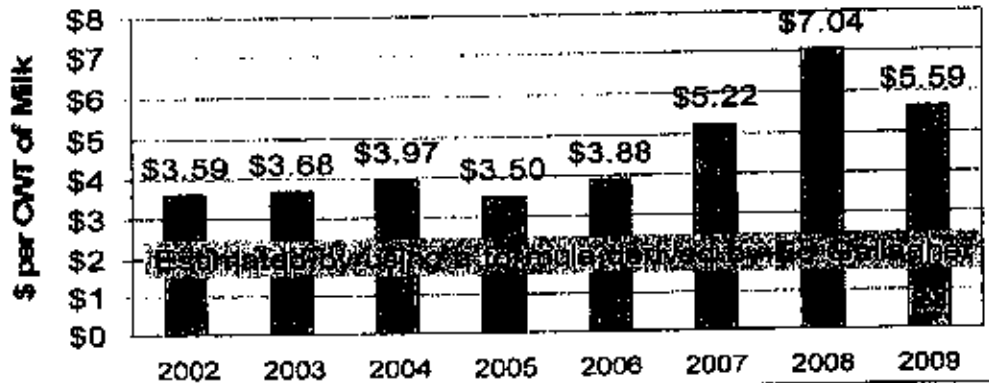
¹ US ethanol production from the Renewable Fuels Association website at <http://www.ethanolrfa.org/industry/statistics/#A>

livestock feedstuffs can be seen in soybean prices. Corn and soybean meal are the two most commonly purchased feed commodities, on dairy farms.



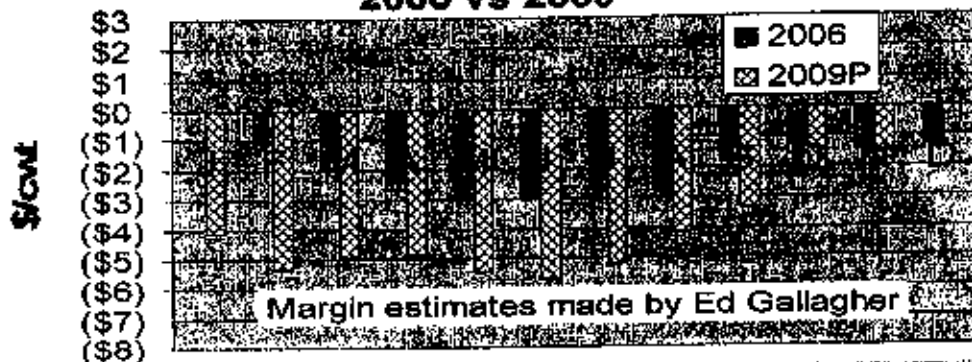
Due to the increased demand for corn from ethanol plants, and its impact on corn and other livestock feed prices, the cost of feeding dairy cows has risen by about \$2 per cwt of milk between 2006 and 2009.

Estimated U.S. Average Purchased Feed Cost 2002-2009



The ethanol impact on production costs has resulted in far more dire economic impacts on dairy farms, today, as compared to 2006. The loss on the average US dairy farm is about \$2 per hundredweight greater in 2009 than in 2006. The losses average about \$75 per milking cow per month. I have heard ranges given from a loss of \$50 per cow per month in the Northeast to as much as \$150 per cow per month in the western states.

Estimated US Net Farm Margins 2006 vs 2009



For a number of years, my dairy policy talks have mentioned that the single best thing that the Federal government can do to preserve strong milk prices is to take actions to assure that the US economy is healthy and growing. The recent financial problems experienced, first here in the US and later around the globe, which hurt our economies and caused a recession, are the primary reason milk prices are so low.

The reason the US has seen a significant price decline has more to do with a shock on demand than anything else. This shock is not occurring in US consumer

demand for dairy products – despite the worst recession, maybe since the Depression, the US consumers' demand for dairy products is up significantly – by about 3.3 billion pounds, milk equivalent. Instead, the demand shock occurred on our dairy exports. The US created financial crisis has caused a worldwide recession. This significantly reduced the demand for dairy products in emerging markets, the Middle East and Mexico – countries that had been aggressively buying our dairy products. Add in complications from China's melamine problem and significantly more milk production from the world's largest exporting country – New Zealand, and our exports were significantly reduced. I estimate that the US lost about 5.6 billion pounds, milk equivalent, of exports. Using data from US Dairy Export Council, I estimate that worldwide exports have shrunk by about 11 billion pounds, milk equivalent. As can be seen, the bulk of that loss occurred to US exports. Recent USDA data shows that US dairy exports have stabilized and are beginning to grow. Economic performance is improving in the US and around the world. I am cautiously optimistic that we have seen the bottom of the export decline and that, as we saw the biggest erosion in export volumes of any other country, we will see the largest gains in the coming months.

Dairylea, Dairy Farmers of America, St. Albans Cooperative Creamery and our other Northeastern US cooperative partners have fought very hard to win Federal stimulus money to support dairy farmers. In December of last year, the dramatic decline in US exports and the poor global economic performance signaled a dramatic downturn in milk prices. We put together a "triage" team that included senior management of the major northeastern cooperatives. In early January, with the support of Bob Gray, we were the first dairy group to go to Washington and ask for Federal stimulus funds to support the dairy industry as well as ask for USDA action in other areas. This activity and others like it from the National Milk Producers Federation and other farm organizations, eventually culminated in the tremendous actions undertaken by USDA Agricultural Secretary Vilsack including the full funding of the Dairy Export Incentive Program for the 2010 and 2011 fiscal years, the purchase of 200 million pounds of nonfat dry milk powder for food programs, and the increase in the dairy price support, among other activities. On behalf of the 2,200 members of Dairylea Cooperative and its management team, we commend Secretary Vilsack for his bold and swift moves to support America's dairy farmers.

Additionally, these combined efforts led to the \$350 million dairy stimulus included in the 2011 Agricultural Appropriations Budget. Of this, \$60 million has been earmarked to be used by USDA to buy dairy products for food pantries and other food programs. We expect the purchase of these products to have a strong and positive impact on dairy farmer milk prices. This impact may begin to be felt in late fourth quarter milk checks. The remaining \$290 million is expected to be paid to dairy farmers in some form of direct payment. We request your assistance in making sure this money to lands in dairy farmers' accounts before the end of the year.

On all these initiatives, Dairylea's members and management team thank the members of the Agricultural Committee for their efforts in ensuring these activities came to fruition.

I am bullish on milk prices for the near term and throughout 2010. Part of the near-term bullishness is due to the \$60 million available to USDA to buy dairy products. The biggest bang for the buck will occur if USDA uses the \$60 million to buy Cheddar cheese. We ask that the funds be used in this manner.

I do believe the worst of the milk pricing crisis is behind us. The gross milk price in Central New York may be above \$15 per hundredweight for November's milk production (received by farms in December). This is an all-in price that includes full component payments, the producer price differential and competitive premiums – but not the MILC or other direct payments. This is more than a \$3 per hundredweight increase from this summer's prices. With modest growth in worldwide economies and no significant milk supply growth, 2010 prices could be at this level and higher.

I presented the following forecasts at DairyLea Cooperative Inc's 102nd Annual Meeting, two weeks ago. These forecasts are dependent on a number of factors. Since these factors are very difficult to gauge in advance, we developed a range system for forecasting the 2010 milk price. All forecasts are for the Central New York area gross milk price which includes full component payments and premiums.

The highest range, with an annual average ranging between \$19 and \$22 per cwt, would occur if there were rapid worldwide production declines and a corresponding rapid increase in demand, which would lead to a dramatic increase in US exports. This scenario envisions rebounding worldwide economies and sluggish or declining milk production around the world. There is about a 20% chance that this forecast could occur.

The mid-level range, with an annual average ranging between \$16 and \$19 per cwt, would occur if US milk production flattens out or rises slowly, worldwide milk production doesn't grow very much, and US domestic demand and export demand grow slowly. This scenario includes sluggish economic growth in the US but somewhat better growth in key US exporting countries. About a 45% probability has been assigned to this outcome.

The lowest range, with an annual average ranging between \$13 and \$16 per cwt, would result if the US and other countries see a double-dip recession slowing US demand and export growth and if milk production grew more than a nominal amount. A 35% probability has been assigned to this outcome.

As with all annual estimates, there are monthly prices that may fall above or below the annual average forecasts. For instance, in the mid-range forecast, a monthly price of \$15 or \$21 could occur and still have the annual average fall into the \$16 to \$19 range.

Right now, the dairy farming sector needs to heal. Almost every farm has taken on significant debt to cash-flow their operation through this down turn. These debts are significant. More so than any other year, we are hearing horrible stories about dairy

farmers being cut off by their banks and suppliers. Many of those that have not reached this point live in fear that they soon will. This crisis is not that different than the one that faced the banking industry during the height of their crisis. The Federal government stepped up on a number of fronts that generated cash to maintain liquidity. The dairy farming sector needs to be flooded with cash right now. The Federal government and USDA have stepped up to do their part. As you can see from the attached handout, DairyIdea and DFA have stepped up for their Northeastern US members. We are asking individual states in the Northeast to step up with financial support, as well.

Dairy farmers are going to need strong price recovery for more than a year in order to get their financial positions back to pre-2009 levels. Even in the midst of strong price recovery, supplemental direct payments will be needed to help dairy farms pay off the significant debts they have taken on to keep their family-businesses afloat during this crisis. We ask that you rally your Northeastern US state-legislative colleagues in support of state-level direct payments.

We need help on the cost-side as well. We are concerned that excessive speculative investments can, from time-to-time, cause higher commodity prices – pushing up feed and energy prices which drive up the cost of producing milk. We have been proponents of greater oversight of swap dealers using commodity futures. In mid-June, we wrote to the Commodity Futures Trading Commission asking them to change how they view swap dealers entering into futures transactions on behalf of investors transacting with them.² We asked the CFTC to look through the swap dealer and determine if the swap dealer's customer was using the swap as a legitimate hedge or as a speculative investment. If a speculative investment, then place speculative limits on that entity as if they were transacting directly in the futures market. As you deliberate on these derivative type issues, we ask that you take actions to limit excessive speculation that rewards a few at the expense of the masses via higher livestock feed, food, energy and other natural resource prices.

Longer term, there is much more work to do.

Milk price volatility is going to be a recurring problem. We do not believe there is any acceptable method to eliminate it from the industry. To do so, you will need to close the borders to imports – ala Canada³, or utilize Federal funds to artificially support dairy prices above those that would be derived in the marketplace, as was done in the late 1970's and early 1980's. Barring these policy initiatives, milk prices will continue to experience large increases, followed by large decreases.

It is of utmost importance that dairy farmers understand how to use price risk management tools to protect their farm businesses against a significant decline in milk prices. DairyIdea and DFA have developed the industry standards in risk management/forward contracting options for our members.⁴

² A copy of the letter is attached to this testimony.

³ This will most certainly result in a loss of US dairy exports as well.

⁴ DairyIdea's risk management offerings can be viewed at <http://www.dairyriskmanagement.com/>

This year, a number of our members had a portion of their milk production protected via milk price forward contracts. In some cases, members received more than \$8 per hundredweight above the market price, on their forward contracted pounds. These programs can be used to create meaningful and important milk price safety nets. Our programs have matured beyond those that just lock someone into a price. We have a number of programs that allow members to get some or all of higher prices – that exceed their floor price. Additionally, we are in the final developmental stages of a program that allows members to lock into the margin between their milk price and primary feed costs – protecting their non-feed margins and holding members harmless to the vagaries of feed price volatility.

The Federal government has devised a milk price insurance program. The Chicago Mercantile Exchange operates dairy futures and options markets for dairy farmers to hedge their milk prices. These tools need to be more widely used by dairy farmers. I am encouraged by the activity of the New York Center for Dairy Excellence and the New York Farm Viability Institute and their counterparts in Pennsylvania to work with the broader industry to promote risk management education. More risk management education, improved programs and financial incentives are needed to change the practices on dairy farms so that they are more likely to use these tools that can protect against the financial ruin of their business.

Your help is needed. I am part of a National Milk Producers Federation Task Force to develop a better and more effective milk price insurance program. When it is devised we will need your help in getting it implemented. Financial incentives are needed to encourage broader use of risk management tools. I am circulating a proposal among a number of colleagues that would create a program to provide financial incentives to dairy farmers for using milk and feed price risk management tools that utilize some form of a futures option as a means of hedging. This incentive would be available to dairy farmers that forward contract their milk through a cooperative or proprietary handler, purchase milk price insurance or utilize their own futures account.

Right now the US is exporting about 8.7 percent of its milk production – down from over 10 percent a year and a half ago. The US imports the equivalent of about 3.4 percent of its milk production – creating a healthy and valuable positive balance of trade.