THE STATUS OF THE U.S. DAIRY INDUSTRY

It's good to be here, but boy, I'll have to admit my timing at making presentations in Atlanta is bad. It was probably more than ten years ago that I was invited to this conference to speak on the BST controversy. Then I was here at SUDIA's annual meeting in March of 1999. I spoke on dairy promotion. But the big topic of the day was the $6 drop we had just seen in the Class III price going from $16.27 in January 1999 to $10.27 in February. Well, here I am again. The BST controversy is alive and well. And now we have Class III futures below $10. What we wouldn't give for 1999 costs.

Nevertheless, I am pleased to be with you. I just wish I could have been here for all of your sessions. Besides, you've heard the expression that the first liar doesn't have a chance. Well, the last speaker also doesn't have much of a chance to say something that you haven't heard in the past 24 hours.

I'm not here to talk about Hoard's Dairyman, but people sometimes ask us how things are going for us. Well, no business, whether in the dairy industry or not, has been spared from the current economic turmoil.

But things could be worse. We employ about 150 people, counting our farm and commercial printing business, but have not had to lay off people. However, we are hiring fewer temp workers in our printing plant. We published a total of 796 pages in 2008 (about half is advertising each year). This compares to 848 pages in 2007 and 856 pages in 2006.

Because of the economics of the dairy business and some problems we've had with our new manure storage, we have put off Phase II and III of our expansion. Our January check for December milk was $19.42 (remember, we have Guernseys). That was $6.92 below what we got for December 2007, and it is not covering our expenses.

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On the matter of costs, the 2008 average for a large group of relatively large Upper Midwest dairy farms was $16.74. The most recent cost figure we've seen from California is $19.21. When we consider that USDA's projected all-milk price for the year ending next September is $12.20, we get an idea of how grim the situation is.

That's the "how bad." What about the "how long"? It will take a turnaround in the economies of the U.S. and countries around the world for strong demand to return to markets for dairy products and ingredients. And that will take time.

For 2009, the International Monetary Fund predicts the first contraction since World War II of the gross national products among developed countries . . . those with incomes and credit to generate demand for animal products. World dairy markets are expected to be depressed for most of 2009. U.S. dairy exports may decline as much as 25 to 35 percent.

However, the outlook for 2010 and beyond should be much better. There is continual growth in the number of people around the globe who want to consume more meat and dairy products. When they again have the money to spend on animal products, they will spend it. Fortunately, the U.S. is uniquely positioned to take advantage of the rebound in world demand that is expected.

Mike McCloskey, with Fair Oaks Farms and CEO of Select Milk Products, said at the U.S. Dairy Forum earlier this month, "During 2007 and early 2008, we may have had a quick glance through the window of the future when it comes to export potential. The world market is coming, and it will be good."

"What global economies need is a recreation of confidence," was the message from Bruce Scherr, CEO of Informa Economics. "And we're close to that." He pointed to LIBORs (London Interbank Overnight Rates) that have fallen from 3 and 4 percent down to 1 to 2 percent. Scherr said that means banks are more willing to lend money to other banks and it signals an easing in the world's credit crisis.

Scherr talked about commodities being priced at their "real value" rather than a speculative value. Crude oil in the $75 to $100 a barrel range is possible . . . $140 again is not likely. He said corn in the $4 range may be a "real value".

Now we have a new administration and with it expectations of new ways of doing business. Of course, to a great extent, it will be members of Congress, on both sides of the aisle, that will determine the speed and degree of change.

But, Congress itself already has been changing. Just one example was when climate-minded Rep. Henry Waxman (D.-Calif.) replaced auto industry-linked John Dingell (D.-Mich.) as head of the influential House Energy and Commerce Committee.

Early on, the new Administration singled out farm program payments as an area that needs reform. One of the new ag secretary's first orders of business is to tighten eligibility rules for farm programs.

Tom Vilsack, the former two-term governor of Iowa, is pro-biofuel. Of course, everybody is talking about second and third generation ethanol production, meaning more cellulosic and other feedstocks, but we're a long way from being there. Also, Vilsack has been pro-biotech. He was the founding chairman of the National Governors' Association Biotechnology Task Force. He appears to want to spin more farm aid toward conservation practices and environmental measures, rather than direct program payments. President Obama has make it clear that excessive farm program payments are on his hit list, but that his leanings are toward preserving family farms and protecting the environment.

As an aside, Tom Vilsack is a poster child for perseverance and serendipity. As an infant, he was left on the doorstep of an orphanage, and his childhood was spent in a quite disfunctional foster home. A native of Pittsburgh, he joined his father-in-law's law firm in Mt. Pleasant, Iowa, a town of 8,000. A disgruntled citizen marched into Mt. Pleasant's city hall in 1987 and shot the mayor. Vilsack was appointed to fill the spot, and that was the start of his political career.

As mayor of Dallas, U.S. Trade Representative Ron Kirk promoted "free" trade, but some analysts expect there to be more focus on the environmental and labor-related aspects of current trade deals including NAFTA.

Trade will be important. But we have to be careful. There was campaign talk about repealing NAFTA and Mexico is our largest dairy customer by far. However, we sure don't want to get into a free trade deal with New Zealand which has been talked about.

Passionate about climate change, Energy Secretary Steven Chu favors putting a price on greenhouse emissions. EPA's Lisa Jackson is called "not shy about enforcement and regulation" by New Jersey Farm Bureau. "Energy czar" Carol Browner brought a "take no prisoners" approach to water and air regulations as head of EPA during the Clinton administration.

On the environment, we're not too optimistic about dairy farm income coming from selling of carbon credits, although we admit we have a lot to learn. Methane digestors offer some of the greatest potential, but you can't do much for less than $1 million, very few operating would have been built without a lot of grant money, there's tremendous maintenance expense especially with generators, and utilities haven't shown they're willing to pay a premium for the output. Besides, you need something like foodwaste to make digestors efficient, but then you're stuck with more nutrients to dispose of under your nutrient management plan.

I know you heard about the Sustainability project yesterday. It looks like the cow herself is going to be a substantial contributor to milk's carbon footprint. In fact, one of the subgroups of the sustainability project is "The Cow of the Future".

There is no university or other research station that is as well equipped to get a handle on greenhouse gas emissions from cows and, more importantly, tell us how to reduce those emissions than the U.S. Dairy Forage Research Center. While it is based in Wisconsin, its work has had national and international impact. The Center is developing plans for a new facility for some 400 cows that will include an intensive digestion facility capable of measuring total cow input and output. In addition, there will be 48-cow grazing research facility that will investigate grazing issues, many of which are just as applicable here in the Southeast as they are in Vermont, Missouri, or Minnesota. All confinement-type forage digestion and utilization work there has application in all parts of the U.S.

We encourage individuals and dairy and farm organizations to support funding of the new research facility, especially critical right now are contacts with the Senate Ag Committee appropriations subcommittee.

Back to Washington, last fall, FDA revoked a ban on off-label use of cephalosporins among food animals. But that revocation may be temporary, and don't be surprised if restrictive, antibiotic-related legislation, which gets introduced every year, goes further in the new Congress.

The Humane Society of the U.S., fresh off it's Proposition 2 victory in California, says it now wants to put more emphasis on federal legislation rather than state referenda and initiatives. That group had urged its 10-million-plus members to e-mail President Obama that they wanted animal welfare to be a high priority for the next Secretary of Agriculture. It looked like it worked. Pressure from HSUS kept former Texas Congressman Charlie Stenholm from strong consideration as a candidate for Secretary of Agriculture. It was Charlie's stand on humane slaughter of horses that was the big factor.

Stenholm told the U.S. Dairy Forum the week before last, "The true goal of HSUS is to eliminate animal agriculture in the U.S. . . . and they are winning." The organization raised $130 million in 2007.

We can bet food safety issues are going to be big. At the Dairy Forum, Connie Tipton, CEO of the International Dairy Foods Association, reminded us that voters are consumers, too. On election day and in the grocery store, they want "a clean and healthier environment," "safe, healthy, good tasting, and affordable, food," and "accountability by their government and business leaders."

Consumers expect more from the government in monitoring the food supply. While 73 percent of people polled regard the overall food supply as safe, nearly half (48 percent) said their confidence in the food supply has decreased. Only 54 percent thought the government was doing all it can to ensure food safety.

These attitudes will support interest a COOL (Country of Origin Labeling) for dairy just as we now have for meats, fish, produce, and peanuts.

Major immigration reform seems unlikely in the near future. There is some hope for the AgJOBS bill. It would provide a path for legalization for workers who have been in the country for a certain period of time, although it will face opposition from some as being “amnesty”.

Of course, as I said earlier, BST is in the news again. This issue may not have resurfaced were it not for the organic movement. There was a shortage of organic milk, so marketers wanted some other milk that they could charge more for. Most in the industry we’ve talked to have been impressed with the approach that Elanco has taken to date. Their top priority has been to meet quietly with retailers and stay away from Labeling debates and other such forums.

While there’s been growth in organic dairy product demand, sales of organic fluid milk are holding pretty steady at about 3 percent of all fluid milk sales.

We’re pleased about the direction our dairy promotion efforts have been making in recent years. Strategic alliances have replaced advertising, and we’re excited about the impact our check-off dollars are having in fast-food menus, improved school milk programs, the new Innovation Center for Dairy, and a new affiliation with the NFL.

You may already have been told at this meeting that we have some major nutrition policy challenges ahead of us. A committee of experts has begun work on a new set of *Dietary Guidelines for Americans* which provides the basis for federal nutrition policy and nutrition education activities. The Child Nutrition Reauthorization Act is up for renewal. That has big impacts on meals and snacks available in schools. And we’re facing changes in the WIC program.

The nutrition work we’ve funded will go a long way toward keeping dairy products well positioned in the minds of the medical and dietetic communities. Fortunately, we have the staffs of Dairy Councils providing sound science and groups like National Milk that can go to bat for us.

One of our next issues will have a full-page article about the school milk program in the Southeast. It sound like you have the highest level of "new look" participation. Schools (K-12 public and private) account for 7 percent of milk sales. It is 65 percent flavored and 35 percent white. The average student consumes 3.7 servings of milk a week . . . 4.3 among elementary students, 3.1 among secondary students. When students have a choice between white and chocolate, average consumption is 3.45 servings. When three varieties of milk are offered, consumption jumps to 3.77 servings. With four or more choices, servings go up to 3.87. Average servings consumed ranged from 2.6 per student in California to 4.9 in the St. Louis area.

In our January 25 issue, we discussed the CWT program and its challenges in the face of huge, negative market forces. With sub-$10 Class III futures in spite of 61,000 cows going to town, it is logical to question CWT. Being supporters of CWT both in the magazine and at our farm, we initially were disappointed to see what the markets did after the herd reduction announcement. But, in reality, December's slide in cash and futures prices resulted simply because an accumulation of market forces overwhelmed CWT's market impacts.

Through October, American cheese output had been up 4.3 percent. Yet, commercial disappearance of American cheese was up only 0.4 percent. The restaurant trade, where a lot of cheese gets used, was down. Indeed, American cheese stocks declined by only 20.4 million pounds during October and November, smallest drawdown since 1996. We ended the year with 3 percent more cheese in storage than a year ago.

In no way are we suggesting that CWT is not effective and not a good investment. The cows in the two 2008 herd reductions represent at least 1.6 billion pounds of milk production potential. That was about 0.8 percent of expected 2008 production. You can't remove that much milk and 86,000 cows without having significant impact. Without CWT, our prices will stay low longer during times of surplus production and growing inventories.

We were disappointed to learn that Southeast Milk voted to not participate in CWT. We believe it remains a good investment for those who contribute. It remains an unmet obligation for those who do not.

There is an attempt to get a loan guarantee through the stimulus package or some other means that will enable CWT to remove more cows in the near future while the program gets longer-term commitments from member co-ops. And the folks in the Northeast are working with the Congressional Budget Office to show that such a loan guarantee actually would reduce MILC payments enough that there would be a net savings to the government.

Calls for federal order reform continue. Every one in our industry, dairy farmers and dairy processors alike, seem to have this love-hate relationship with federal orders. Orders and the way they are administered, and especially how they are amended or how slowly they are amended, give us all something to complain about. But when push comes to shove, most people, producers and processors alike, prefer the devil they know to the devil they don't know. Few want to do away with federal orders completely, and those that do should proceed with caution.

But federal orders are contentious. As some of you may know, there has been a National Milk task force on federal orders that met several times over a period of months. The proposal considered was a two-class system, fluid and manufacturing milk, with Class I differentials much like we have now. The manufacturing milk base price would have been determined by a USDA survey of pay prices in areas of strong competition for milk, similar to the old Minnesota-Wisconsin price. It appears that there will be no end to the wrangling that we have had over make allowances and yield factors with the product formula pricing system we have had since 2000.

But there was no consensus that this proposal would be the way to go. As an aside, some producers in California are campaigning to end their state order and become a federal order.

Cheese has helped drive demand for milk for years. But the current demand situation is putting continual pressure on the cheese market.

Demand is down for both American and other varieties. The bulk of the non-American varieties are Italian, most of which is mozzarella. This is important because in recent years we have produced more Italian cheese in this country than we have Cheddar and other American types.

Italian demand can be described with one word: pizza. An amazing 28 percent of cheese is consumed on pizza. And 43 percent of the U.S. milk supply is used to make cheese. So, the milk from one cow out of eight ends up on top of pizza. The top 10 pizza chains use 30 percent of all mozzarella we make. Just one less ounce of cheese on each pizza they sell results in 250 million pounds less cheese sold.

One good bit of news is that the folks at Dairy Management, Inc., have worked with Domino's on a pizza offering that will contain 50 percent more cheese than its regular pizzas. Hopefully, other pizza chains will develop similar products. Survey after survey has shown that people like more cheese on their pizza.

Still, we can't continue to count on cheese to underpin our milk prices. Up until recently, cheese production in this country grew between 3 and 4 percent per year. It will be more like 1.3 percent growth when 2008 is tallied.

One bit of good news we keep coming back to is that people still like our products. Per capita consumption of all dairy products on a milk-equivalent, milkfat basis rose again in 2007. We don't have last year's numbers yet. The total in 2007 was 610 pounds . . . the highest level in 45 years. The gain was a slim 1-pound jump, but the fact that consumption went up at all was significant given that wholesale and retail prices were up substantially for the last half of the year.

Total cheese consumption on a per-capita basis climbed to 32.68 pounds last year, up 0.12 pound from the year before. During the past 20 years, cheese use per person has jumped nearly 36 percent. But, as I've said, there are concerns about what cheese use will do in the future. People in some countries such as Greece and France consume as much as 50 pounds each or more, we still have a lot of potential for growth in that market.

Beef is our other product. In 2007, per capita beef consumption slid slightly from 65.8 pounds to 65.2. However, beef demand has held steady in recent years. This especially is noteworthy when we take into account that chicken consumption has shot up to around 85 pounds per person, and even pork use has been edging up lately (50.8 pounds last year).

This has been the so-called “30,000-foot-high” view of the dairy industry from our perspective. It is not a happy time. But let’s be encouraged by the fact that we’re working with a wonderful beast in the dairy cow, our products have broad appeal and unequalled nutritional value, and we work in an industry characterized by love of the land and generations of families working side by side.