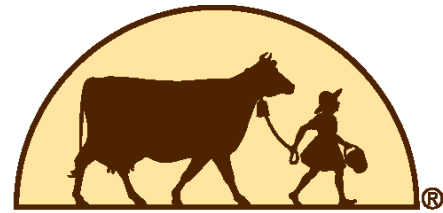




**International Dairy Foods Association**  
Milk Industry Foundation  
National Cheese Institute  
International Ice Cream Association



**Blue Bell**<sup>®</sup>

**Statement of Paul Kruse  
CEO and President  
Blue Bell Creameries, L.P.  
on behalf of  
International Dairy Foods Association**

**Before the Subcommittee on Livestock, Dairy and Poultry  
Committee on Agriculture  
United States House of Representatives  
July 14, 2009**

Mr. Chairman and members of the subcommittee, thank you for the opportunity to appear before you today. I am Paul Kruse, the CEO and president of Blue Bell Creameries based in Brenham, Texas. We have facilities across 18 states in the South and Southeast United States including the districts of Chairman David Scott, and Subcommittee Ranking Member Randy Neugebauer. Blue Bell has been in business since 1907. Today the company manufactures a full line of ice cream products and is recognized as the third largest ice cream brand in the United States.

I am speaking today as chairman of the International Dairy Foods Association. IDFA's 220 dairy processing members run more than 600 plant operations, and range from large multi-national organizations to single-plant companies. Together they represent more than 85 percent of the milk, cultured products, cheese and frozen desserts that are produced and marketed in the United States.

Today I would like to discuss the status of the dairy industry in the United States, some the trends that have brought us to where we are today and our industry's enormous opportunity for growth.

Many in the dairy industry are facing some very difficult times. Yet, we urge this committee to avoid establishing new programs that will limit our industry's ability to grow. It is more appropriate to first examine our existing dairy programs. Are these outdated programs actually contributing to the problem? Can we find some better long term programs that help farmers and that will help our industry to meet its potential for growth?

Dairy remains a key component of our nation's agriculture industry. Nationwide, the dairy industry employs hundreds of thousands of people on farms, in processing plants, through marketing and transportation, in retail stores and in companies that supply inputs to the dairy industry. Dairy processors are in the middle of this equation. We depend on our dairy farmers and cooperatives for a reliable and high-quality milk supply to make our products. We have developed tremendous trust and reliance in these relationships. At the same time, our customers depend on us to deliver the nutritious and delicious products they want.

There is not a dairy product manufacturer in this country who takes for granted the great resource we have in our U.S. milk supply or the dairy farmers and their families and cooperatives that make it possible. This partnership between milk producers and milk manufacturers is critical, and the policies and programs that you consider here on Capitol Hill can affect that partnership in both positive and negative ways.

## **Today's Dairy Industry**

There are different ways of measuring how farm milk is used, but roughly 45 percent of domestic milk production is used for cheese; 30 percent for fluid, or beverage milk and 10 percent for frozen products like my favorite dairy product, ice cream. The remaining 15 percent is used for butter, nonfat dry milk and other products.

Although nearly every state, including Alaska and Hawaii, has at least a few dairy farmers, nearly three quarters of our nation's milk production currently comes from the top ten dairy states of California, Wisconsin, Idaho, New York, Pennsylvania, Minnesota, Michigan, Texas, New Mexico and Washington.

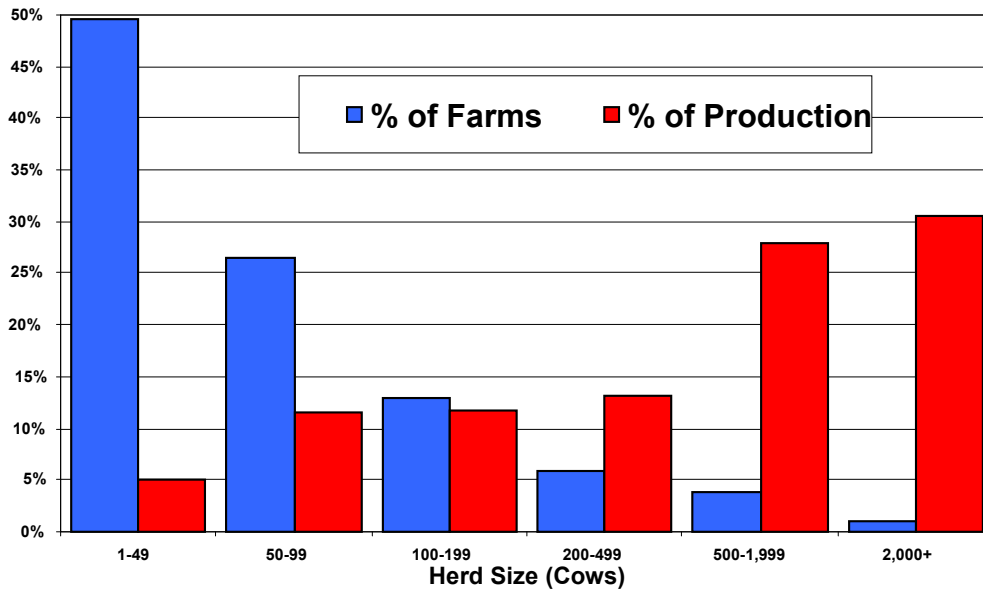
Dairy processors, as one would expect, are clustered in these same areas. As an industry, dairy processors directly employ over 120,000 people. Regional growth in milk production is now most often driven by a dairy processor's decision to build a new plant or increase capacity in an existing one.

Decades ago, most dairy products were only marketed locally or regionally, but with advances in transportation and efficiencies in production, most of our dairy products are now marketed regionally and nationally. In addition, a growing global market has increased demand for products such as milk powders that can be easily incorporated into many other food products.

The dairy industry is defined by a few fundamental trends that often explain governmental policy towards the industry.

- The number of dairy farms has decreased dramatically over the last several decades. When federal dairy programs were first established some 70 years ago, there were over 4.6 million dairy farms and 22,000 dairy plants to serve our population of 132 million people (1940 data). We now have around 67,000 dairy farms, and about 1,200 dairy plants to support nearly 300 million people. Most states have witnessed a constant and steady decline in the number of dairy farms and dairy plants over several decades.
- The majority of milk production has moved from small dairy farms to large ones. In 2008, almost 59 percent of farm milk production came from only 5 percent of our dairy farms, those with over 500 cows. In 1940, less than 1 percent of farms had 30 or more dairy cows, and over 90 percent of milk production came from farms with fewer than 30 cows. The rapid growth of the nation's dairy industry over the past few decades, especially in the Western states but a trend everywhere in the country, is almost entirely due to the development of very large dairy farms of 5,000, 10,000 or even 15,000 cows.

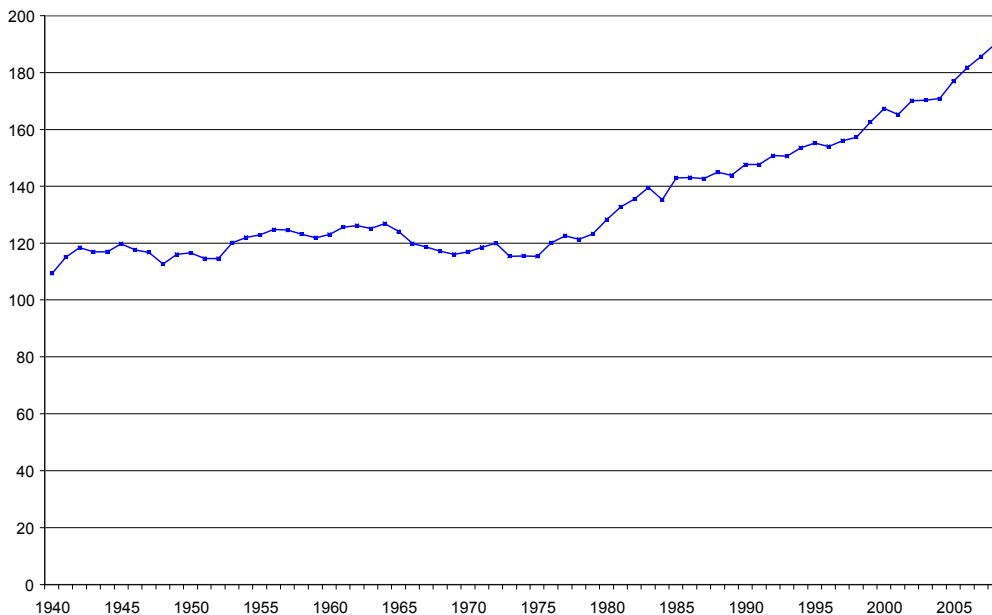
### Number of Dairy Farms by Herd Size



Source: USDA, NASS

- For decades, these changes in the dairy farm sector, combined with an overall decline in per capita consumption of all milk and dairy products, limited overall growth in the industry. Total U.S. milk production was held to around 120 billion pounds between 1940 and 1975. Since then, milk production has soared and continues to grow annually.

### Total Milk Production

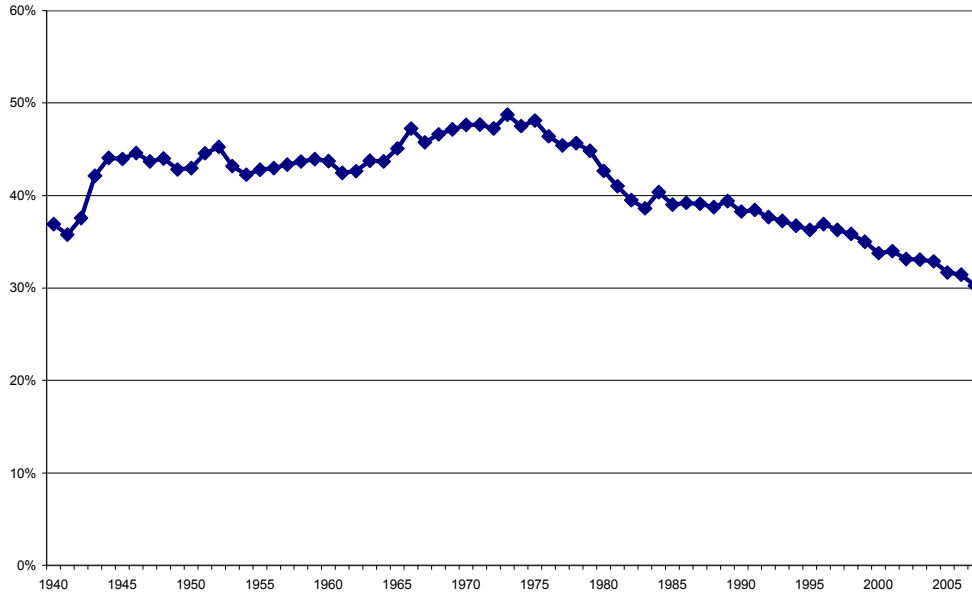


Source: USDA, NASS

- While farm milk production has increased dramatically, the percent used in fluid dairy products fell from nearly 49 percent in 1973 to barely 30 percent in 2007. Annual fluid milk consumption has fallen from 30 gallons per person in the early

1970s to barely 20 gallons per person today. With population growth, this means that total fluid milk sales in the United States have been stagnant for decades.

### Percent of U.S. farm milk production sold as fluid dairy products



Source: USDA, NASS

- Cheese sales, however, have significantly increased and accounted for nearly all of the growth in total dairy sales over the past few decades. Per capita frozen dairy product production has declined over the past 15 years, from nearly 30 pounds in 1994 to around 24 pounds today, but total production has remained relatively steady in recent years thanks to population growth.

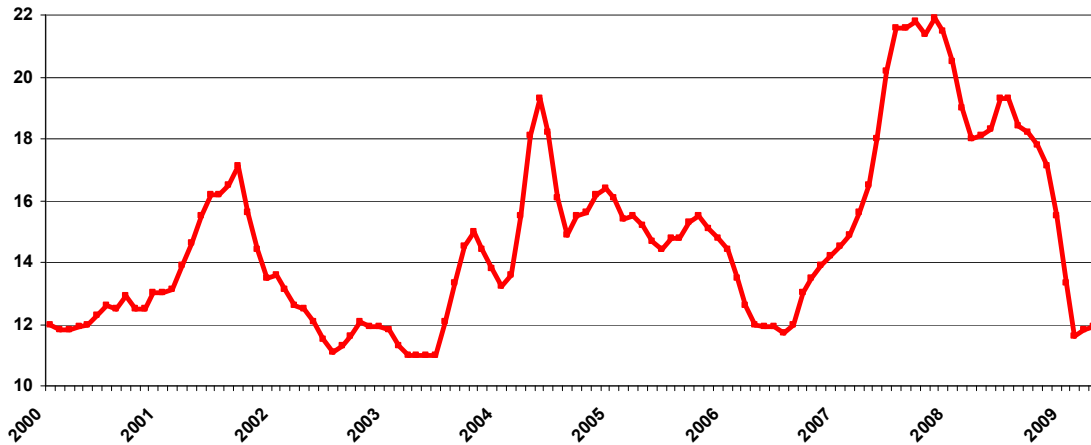
### Dairy Lacks Risk Management Tools

This is a difficult time for many in the dairy industry, and I would urge this committee to avoid quick fixes and consider longer term approaches to address our current situation. Here's why.

Milk price cycles are not unexpected. In fact, the U.S. dairy industry has a long history of price cycles. Agricultural price swings are nothing new for any commodity, but other sectors have well established risk management tools that are used frequently by all market participants. The same cannot be said for dairy.

Just five years ago, farm milk and dairy product prices soared to then record-high levels where they stayed throughout 2004 and 2005. But that two-year period of high prices was followed by low prices in 2006. Starting in 2007, the pattern repeated itself. The record high prices in 2007-2008 have been followed by the low farm milk prices seen so far this year.

### All- Milk Price Since 2000



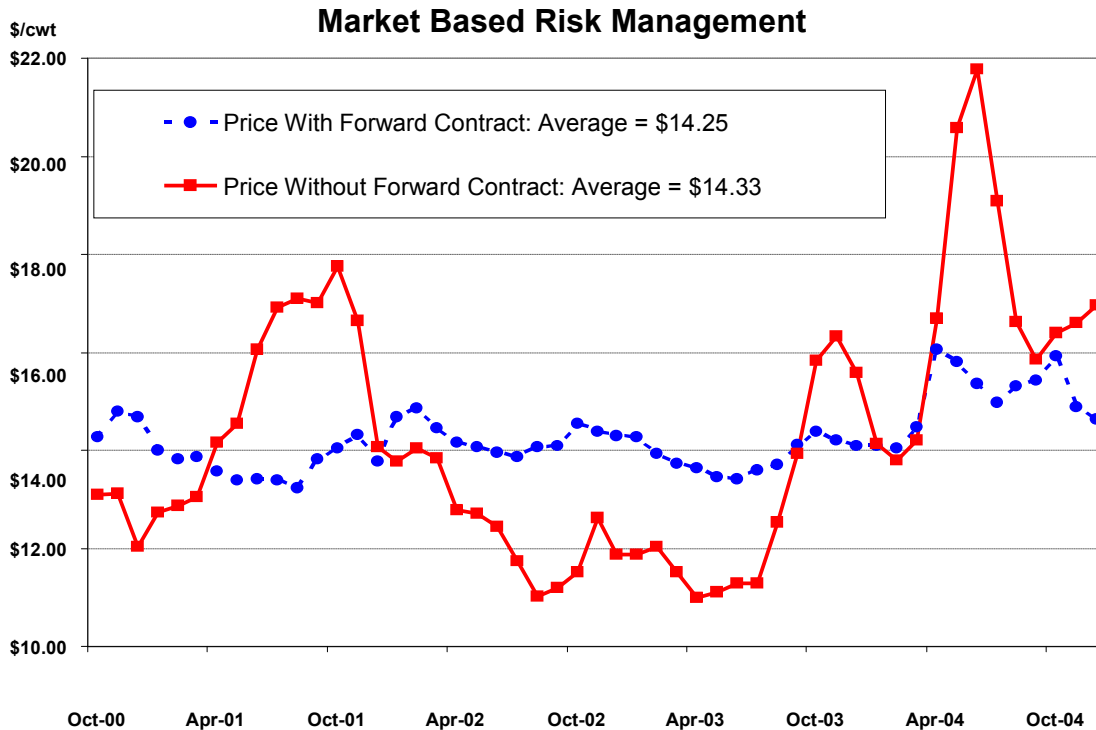
Source: USDA, NASS

Without adequate price discovery and risk management tools, every segment of our industry suffers through the price swings, especially the small producers and small processors. Price volatility makes it very difficult to plan for long term industry infrastructure investments, to capture and keep new markets for dairy products, and to compete with other commodities and foods that have less volatility. Unfortunately, milk price regulations inhibit the use of risk management tools in dairy.

IDFA recognizes that price volatility is a serious problem for everyone in the dairy industry. We salute the Obama Administration for developing credit programs that can assist dairy farmers through downward swings and expanding insurance programs like the "Livestock Gross Margin Insurance Program". We recommend that this committee formally review how extensively this program and other risk management tools are utilized by the dairy industry.

IDFA also supports providing dairy farmers with risk management tools such as the forward contracting program that was reinstated by the 2008 Farm Bill. Forward contracting is one of the most important tools that dairy farmers, processors and manufacturers can use to mitigate price swings. This chart, which uses data that the United States Department of Agriculture collected during the forward contracting pilot program, illustrates how risk management tools can be effectively used.

Some segments of the industry have offered options to address price volatility that will ultimately compound the negative aspects of our current dairy policies rather than eliminate fundamental weaknesses. The Holstein Association USA, for example, has proposed limiting milk supply by taxing increases in production. This proposal would not only penalize many dairy producers all over the country, it will also artificially raise domestic milk prices and make U.S. dairy products less competitive on world markets.



Source: USDA, AMS Dairy Forward Pricing Pilot Program: Information for the Complete Program Periods, September 2000 through December 2004

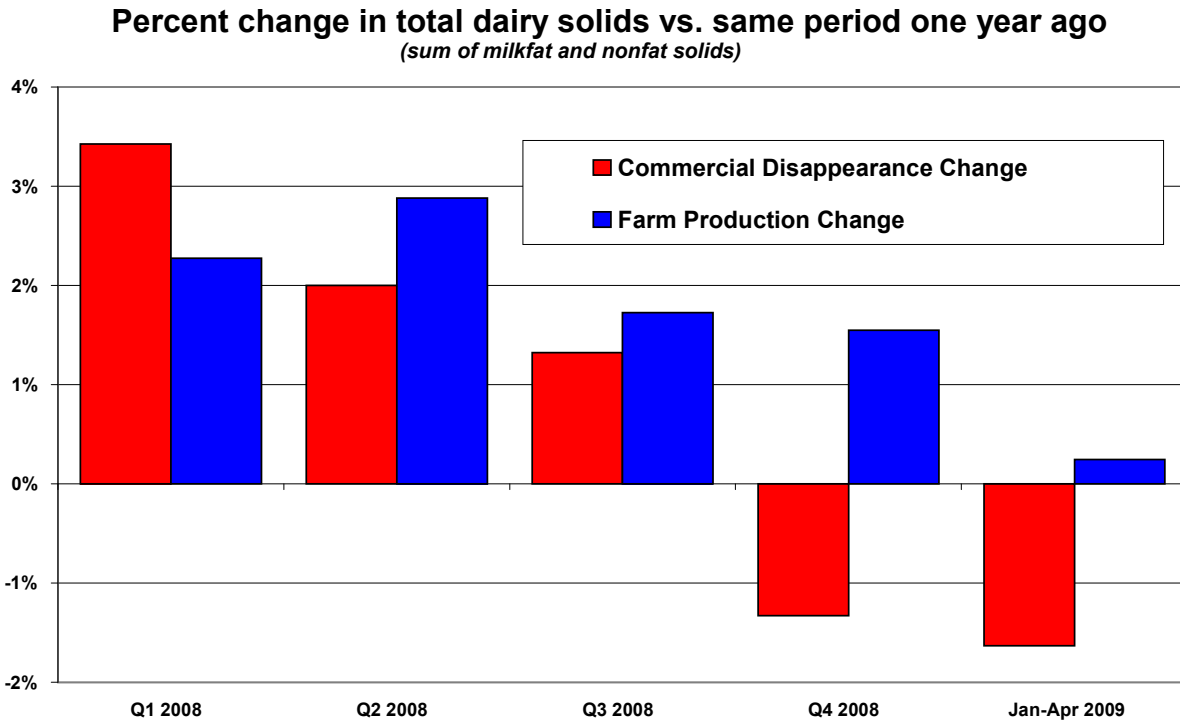
Taxing new milk production also will limit the industry's ability to modernize, innovate and grow. Dairy manufacturing facilities have been built and modernized in many parts of the country where dairy production is growing. Taxing increased milk production will limit investments into new plants anywhere in the country because the infrastructure investments require increased milk supply. Instead of rising to the challenge of capturing new domestic and international markets, the Holstein Association USA plan will penalize areas of the country that are increasing production and those areas that are attempting to revitalize their dairy sectors.

Programs that manage supply or limit milk production would raise milk and dairy product prices and drive domestic consumers to less costly and often less nutritious foods. Propping up domestic milk prices to levels above world market prices surely would cause the U.S. dairy industry to lose enormous opportunities for export growth and to open our markets to increased imports. Jobs that could be created here in the United States would be going elsewhere. At IDFA, we believe that increasing demand for dairy products is the best way to maintain a health dairy industry.

### Consumers Are Buying Less Dairy, Export Sales Are Off

Although too much supply has been tagged by many as the root of our current low farm milk prices woes, it is more complicated than that. The current economic downturn has greatly affected domestic and global demand for dairy products.

The chart below shows that demand for dairy products started to slow down in 2008 and actually decreased in the fourth quarter compared to the same period a year earlier. This decrease has continued so far in 2009.

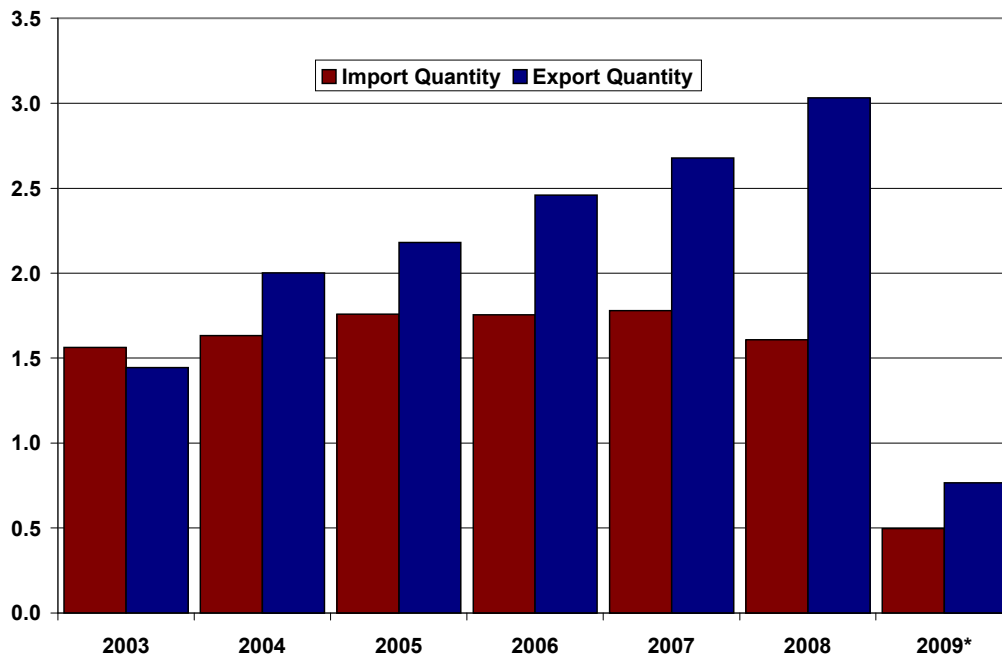


Source: USDA, Economic Research Service

The same negative economic forces we see in our domestic markets have led to the decline this year for U.S. dairy product exports. Our dairy exports increased to record levels in recent years, but have since dropped precipitously. The volatile and complicated pricing system, and the standards of identity that are outdated and not in sync with international demand, will continue to stymie our ability to retain and capture even larger segments of the growing international market.

In 2003, the United States imported a greater quantity of dairy products than we exported, and much of those exports were only possible due to subsidies under the Dairy Export Incentive Program. By 2008, the total quantity of U.S. dairy product exports had more than doubled, without any export subsidies. The U.S. Dairy Export Council estimated that in 2008 the United States exported more than 10 percent of its milk production as dairy products, while imports have remained around 5 percent of domestic dairy product demand in recent years.

### Import/Export Quantity (billion lbs)



Source: USDA, FAS, Through April 2009

### Potential for Growth - Focus on Demand for Dairy

There is good news on the horizon, however. Once the economy begins to rebound, expanding middle-class populations in many nations, particularly in Asia, will help to increase worldwide demand for dairy products. The United States, which already produces more cow milk than any other country, is uniquely positioned to capture these rapidly growing markets. Other major dairy exporting areas, such as the European Union, New Zealand and Australia, are held back in some way. Relatively new entrants to the world's dairy markets, such as Argentina, Paraguay and the Ukraine, are still in the early stages of growing their industries.

Innovative dairy companies around the world have developed new dairy ingredients that are increasingly used in popular products, such as protein enhanced waters, sports drinks, power bars, coffee drinks, cake mixes and crackers, to name a few. Even traditional dairy products are diversifying to meet consumer demand for non-traditional attributes, such as new sizes, flavoring, shelf stability and functionality. Although it is important to the health of consumers, as well as the industry for Americans, to increase consumption of milk and our traditional dairy products, it is equally as important for our industry to meet the growing consumer demand for new and enhanced dairy products. While our U.S. industry has begun this process, our new products lag behind other countries.

## **Current Dairy Programs Limit Growth and Investment**

In many ways, our existing dairy programs stand in the way of our industry's ability to fully take advantage of our trading opportunities and to respond to our competition for new food products here in the United States. Most current dairy programs significantly distort the market for dairy products and limit our industry's growth. At the same time, our existing dairy programs have done nothing to smooth the volatility of milk prices.

Our current policies encourage plants to produce nonfat dry milk, even as few food processors want to use that product. On the other hand, there is growing demand for products like milk protein concentrates which many food processors now source from other countries because the United States does not produce near enough. This committee should consider the reasons why we see continued investment in plants to produce nonfat dry milk and not the specialized milk proteins demanded by today's marketplace. Another problem with the Dairy Product Price Support program is that it has the unintended consequence of making our products less competitive on world markets.

There is a growing consensus in the dairy industry that the Federal Milk Marketing Order system needs to be significantly overhauled. The rigid, complex formulas used to determine minimum milk prices are the source of a long list of egregious problems, such as preventing milk from moving efficiently to its highest value. By that I mean, we should respond to consumer demand, not the artificial price formulas, to determine how milk is valued.

The federal orders limit new investments into the dairy industry by creating unnecessary financial risks for many dairy manufacturing plants. By limiting the returns on investment through the pricing structure, the federal orders have a major impact the location of plant infrastructure, and the type of dairy products that are manufactured. There is a built-in disincentive to manufacture high-value dairy protein ingredients, such as whey protein isolates and milk protein concentrates that are increasingly being used in cutting-edge domestic consumer products like energy bars and sports drinks. The pricing formulas require manufacturers of these new products to pay prices that are based on the wholesale prices of dry whey and nonfat dry milk, completely different products with a different value in the marketplace compared to dairy protein ingredients.

To emphasize this point, there is potential for significant new demand for milk, if dairy plants invest in the infrastructure to make the innovative, value-added, dairy ingredients that are so much in demand today. But because of our regulated pricing system that uses nonfat dry milk and other products to set prices, the return on the investment in the processing technology is very risky. Innovation is stymied by our system of milk price regulations. The result is less milk demand, less domestic milk used and lower prices to farmers.

## **It's Time for Change**

The policies being considered by this subcommittee have a profound influence on the future of our dairy industry. If you choose to limit supply and guarantee high farm milk prices, our dairy industry will likely stop growing and slowly decline as domestic and world markets are captured by our competitors. On the other hand, if you choose to review and reform the current outdated dairy programs, you can provide the environment for a healthy and expanding dairy industry, for both dairy farmers and processors.

With the right policies and programs in place, the dairy industry will be able to retain and gain customers, both here and abroad, by providing traditional and innovative products that address nutritional needs, meet changing consumer lifestyles and plumb new purchasing power.