California’s pricing system is killing its dairies

Some are already gone. More will follow. The big question is, how many can be saved?

The greatest milk-producing machine the U.S. dairy industry has ever seen is breaking down.

Doomsday feed prices and apocalyptic milk price volatility in 2009 exposed a fatal flaw in the “California style” business model of growing no feed. They also triggered a landslide of debt that buried many of the state’s producers and turned survival into a daily struggle. It transformed their financing world as well.

Today, monthly profitability is more critical than most California producers could have ever imagined. Every penny per hundredweight and per ton matters. And yet, the state’s complex milk pricing system that fueled meteoric growth for 40 years not only isn’t helping producers, but some say it is killing them.

The gist of their belief is that the Department of Food and Agriculture has historically interpreted the pricing system as a way to encourage processors to make plant capacity available for every pound of milk that is produced. In the wake of the industry’s 2009 meltdown, however, producers have become increasingly more vocal that the department is ignoring at least two directives in the state’s Food and Agriculture Code that are aimed at promoting their existence:

Section 61805(d) – “Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, maintain about and maintain a reasonable amount of stability and prosperity in the production of market milk…”

Section 62062 – “...methods or formulas shall be reasonably calculated to result in prices that are in a reasonable and sound economic relationship with the national value of manufactured milk products.”

Producer groups have been at odds with processors and the department for years over the “begging with hat in hand” nature of the hearing process to seek price relief, and disgusted with outcomes that have sometimes been small but have more often been nothing. In recent years as economic conditions have reached fatal proportions, unhappiness has escalated into full-blown rebellion.

Multiple meetings have been held to discuss replacing the state pricing system with a Federal Milk Marketing Order (FMMO), and a lawsuit was even filed against the department in 2012 for failing to keep California’s Class 4b (cheese) milk prices in “reasonable alignment” with FMMO Class III prices. The difference averaged $2 per hundredweight during 2011 and 2012.

One of the loudest voices for California milk producers belongs to Geoffrey Vanden Heuvel. The operator of a 1,250-cow dairy in Chino, Vanden Heuvel has been active in California dairy policy making for 28 years. He has testified at nearly every California milk price hearing since 1985 and has occasionally participated in USDA and Congressional Farm Bill hearings in Washington, D.C.

He is candid, direct and extremely well informed. He is also fiercely passionate about the dairy industry, which means he not only has a lot to say about the current state of California dairying, but he is not shy about doing so.

Questions and answers

Has the relationship between California dairy farmers and the Department of Food and Agriculture changed in recent years?

“I don’t think there’s been a change in the department; I think there’s been a change in the economic realities. In order to understand why, you need to get some historical context.

“If you go back to 1977, California was just over half the size of Wisconsin in milk production and the dairy industry convinced Congress to pass a farm bill that supported milk at 80 percent of parity with semi-annual price adjustments. The practical implications were that over a four-year period the support price went from $8.26 per hundredweight to $13.49. What did California dairies do with the money? We invested in more cows and more processing plants.

“But because we had a state order we could use it to essentially confiscate part of the money that was intended to go to dairy farmers and give it to processors as an incentive to build more plants to accommodate the milk that those additional cows were going to make. The bottom line is that with cheap feed we were able to build our industry and we caught Wisconsin within a decade.

“In my opinion it was as a result of that tremendous growth that the department developed the mind-set it still has today which is the problem: that plant capacity is the most important single factor and indicator of what the milk prices it establishes must be.

“Despite the fact that the law that gives the department the responsibility and authority to set milk prices also tells it that it has to consider producer profitability, what milk is selling for in other parts of the country, and the ‘reasonable relationship’ language that is in the law. What you hear time and time again in the questions that department economists ask at hearings is, its concern is the viability of plants. Its equation essentially is that there are 1,700 dairies and 60 plants. If we lose a bunch of dairymen it bothers them, but not near as much as losing one or two plants. The department has a belief that plants must buy milk cheap in order to survive.”

In testimony at the state’s most recent milk price hearing on December 21 you son Rob, manager of Milk Producers Council in Southern California, said, “It is abundantly clear that the needs of manufacturers have been a priority of the California Department of Food and Agriculture over the years.”

“And I don’t think the department would argue with that. In all of its findings it is clear that it is most concerned about putting no stress on the processing sector whatsoever. What’s strange to me is, the practical impact of the department’s decisions is the demise of the productive capacity of milk producers of California.

“I think what the problem comes down to is, the department has become accustomed to doing things the way it has for a long time. It is setting minimum prices only, those prices have to be market clearing prices, and they can nationalize those prices if there is any chance they’ll end up with inadequate plant capacity. It is taking it as their obligation to see that there is a California home for any gallon of milk that any California dairyman wants to produce. That’s the policy it has been implementing for the last 40 years.

“But one of the questions you have to ask is, where in the law is the foundation for that policy? Secondly, and as a practical matter, if California dairymen produce too much milk, who bears the cost of disposal? It’s not the plants; they buy what they want. It’s the dairy farmers. The department is basically saying, ‘We have to kill you to save you.’

“What is happening in the California dairy industry right now reminds me of when I went to Niagara Falls. About a mile upstream is a sign that says, ‘Point of no return.’ It means if you are in the water at that point they can’t save you. I think that is where about 25 percent of our dairies are now – they are still in business, but they are going to go over the falls and they can’t be saved.”

– Geoffrey Vanden Heuvel
We have to keep milk cheap so there will always be a plant to buy your milk. The problem with this is that the department has made it so easy for California plants by discounting milk, we have ended up with very lazy plants. They have no incentive to move up the value chain and make the decisions it made? Why did it ignore the producers?

“Indications are that the department still doesn’t believe us. In its defense, I’ve got to say that I’ve been raising issues about the viability of our model for years – and yet production continued to go up. I think it’s a case where the department isn’t convinced yet that it is doing damage.

Destroying productive capacity

“But the effect of its policy is to destroy the productive capacity of the dairy industry. There is really no arguing that. I think the game changing difference is the banking industry, which made tons of money on the collapse of the California dairy industry as it expanded all over the country, has begun to look at the dairy industry much differently. Clearly, without access to capital we never could have built what we built, and that access to capital is pretty much being cut off today.

“As long as producers have breath and energy in their bodies there will be no peace in the California dairy industry until this issue gets resolved. Unfortunately, we are stuck right now where we have the worst of both worlds. We have producers who are not paying the bills and who can’t pay their bills, and processors who are benefiting from that but are unwilling to risk hundreds of millions of dollars on investment [in new plant capacity] because they intuitively know it can’t last. We’re buying absolutely nothing for our cheap milk right now except misery. 

“If I could sum up the department’s policies during the last 12 months it would be, it’s just stupid. Why would a body whose responsibility is to carry out a law (Section 61805(d) of the Agricultural Code) do what it is doing? If that’s what the state legislature told you to do as an administering body, and you look at the results of its decisions, how can you describe those decisions as anything other than stupid? At some point the department will “get it” or the market will take over.

“Every day that passes as this pressure comes to bear, there is less and less time to fix the problem. We just don’t know how much we have left. As dairy farmers our backs are to the wall. This is survival. When your livelihood is on the line and you’re fighting for your home, it clarifies the mind and energizes you.

“There are some potential remedies we have by going to the California State Legislature, and Western United Dairyman has already introduced such a bill. The state Legislature is going to hear a lot about the plight of dairy farmers in the next six months; this will get attention.”

Near the end of your testimony in the December 21 hearing you told the department panel, “We need a little hope, and I guess the question for the department is are you going to give us some?” Is hope enough or is it just a Band-Aid?

“It’s not enough to solve the problem, but if people have just a little hope they’ll fight. They’ll fight to hang on and stay alive because of the hope that there might be a rescue. But if there’s no hope they’ll quit. I said earlier that change is coming for the California dairy industry; that’s inevitable. The question is, how much of this industry can we save? Hope is a huge factor in the answer. If there’s some hope, producers will put in extra effort to stay alive.

“The other side of the question about how much of the industry can be saved is, how much of the industry that’s still here are we going to lose no matter what happens? The reality is there are a lot of people who are milking cows today that won’t be here much longer because the financial momentum underway in the industry has taken them past the point of being saved.

“I don’t think the department is paying very close attention to that. I think it looks at the supply of milk and sees that we’re down a little, but it thinks we might bounce back and go way up. So it thinks, “we need to be very careful about giving dairy farmers too much money because if we do they’ll produce too much milk and we won’t have a place for it.”

“I want to speak up when, in the department’s shoes; from its perspective it thinks it’s a Band-Aid? Is hope enough or is it just a Band-Aid?

“Of course it is. It’s the most ludicrous thing. Do you think a company with a billion-dollar investment is going to pack up? Where would it go? The crazy thing is, department officials continue to buy that line. Processors aren’t going to go anywhere; we’re not going to close down. In my testimony I told the department, What is the market that your policy decisions created telling me? It’s basically telling me we need to get out of business. Intellectually I’m okay with that. But it is really fair to tell California dairy farmers they ought to get out of business when the state is deliberately discounting their milk?”

Has the current intensity of the disagreement between producers and the department, culminating with the lawsuit against the department claiming it has failed to follow the Agricultural Act, turned any bridges?

“Even though we’re all human beings and we all have emotions, I hope that we are all professionals and we can all put our emotions in check. The process of making a change is much more of a marathon than a sprint. There will be some disasters there when it is over; the question is how much damage will be done. The quicker we can turn this thing around and change, the more of this industry we can preserve and the better it will be in the future. The pain and anguish and loss that have already occurred are enormous. The toll it continues to take financially and emotionally on the producer sector is enormous. The sad part is it doesn’t have to be this way. It just doesn’t. I’ve never seen a situation where a state’s Department of Agriculture is at war with its own farmers, but ours is.

“There’s always been a belief that if all producers could get on the same page then we would get what we need. But we demonstrated that is not true. We had 100 percent producer unanimity in the December 21 hearing. We were all together. It wasn’t for lack of resources and it wasn’t for lack of unity, but we still got nothing.

“California dairy farmers have had a heck of a run. They really have. The California dairy industry has been a phenomenal success story. It was built on cheap feed, but I don’t think feed is ever going to be cheap again. Therefore, the model that built it is forever gone. So it has to adjust and adapt, it will adjust and adapt. The question is, how long will it take and who gets to be part of what is left?

“You’ve always had a certain amount of natural selection going on among producers. That’s normal, but the department is going to kill off more of the human and material capital than it needs to because of the stupidity of its policies. But at some point there will be a change in policy. Of that I have no doubt.”