

## The Northeast Dairy Compact Tool: The First Pioneer Farm Credit Perspective

### Comments to the Northeast Dairy Compact Commission

**James N. Putnam, II**

**Senior Vice President**

**June 6, 2001**

First Pioneer Farm Credit continues to be the largest provider of credit and financial services to dairy farmers in our six-state service area, including the Commonwealth of Massachusetts. Our organization provides some \$20 million of loans to Massachusetts dairy farmers, \$355 million of dairy loans in total and \$1.3 billion to all types of agriculture and agribusiness. As many of you know, First Pioneer is a federally chartered farm credit cooperative that is owned and controlled by our farmer members. We are committed to meeting the financial needs of farmers in our region whether they be large or small, old or young, wholesale or retail, or nontraditional.

First Pioneer has closely followed the development and subsequent evolution of the Northeast Dairy Compact. We are pleased to have had the opportunity on several occasions to provide information and analysis on behalf of the Compact. The Compact has been a positive tool for the consumers and dairy producers of our region in its short history.

Today I will provide some updated economic analysis based on Farm Credit's *Dairy Farm Summary*, discuss the current challenges of the dairy economy and provide a lender's perspective of how the Compact enters into our lending process.

For over 20 years, Northeast Farm Credit has published an annual *Dairy Farm Summary* based on the summarized financial records of about 500 commercial dairy farm businesses. This provides tremendous insight into the financial dynamics of this industry. The following analysis includes our about-to-be-released 2000 data and is based on a subsample of those dairy farms located in New England. Please see Figure 1.

Cash flow is the lifeblood of a farm business. Ultimately, it is the ability to pay all operating expenses, meet scheduled debt payments and provide a modest standard of living that determines whether a farm business perseveres onward, or makes the painful decision to exit the industry. This chart summarizes the cash flow performance of New England dairy farms for the 1995-2000 period. Let me walk you through the chart:

- Net Milk Price (3<sup>rd</sup> line) is the actual price received by our sample of farmers. It shows the combined impact of the Federal Order or state minimum milk price, any handler premiums and Compact premiums.
- Milk Price before Compact (1<sup>st</sup> line) backs out the net farmer premiums paid by the Compact since 1997. That gives us the opportunity to gain insight as to how Northeast Compact premiums have affected New England dairy farmers' bottom lines.
- Breakeven Milk Price (4<sup>th</sup> line) is calculated as the exact amount per cwt. of milk sold that would have been needed to meet all operating expenses, family living and debt payments.

Below this price, the farmer would not be able to meet all of his/her financial commitments. Above this level, there would be some cash left over to reinvest in the business, pay down debt or maybe even put aside for retirement some day! Note that the breakeven price has fluctuated somewhat over the past 6 years, but has shown no strong trend. This is mostly due to the continuing efficiency gains and tight cost control of New England dairy farmers.

- Cash Margin is the difference between the actual milk price received and the calculated breakeven milk price. It is a direct measure of how well the dairy farm business is cash flowing. I have shown this on the basis of actual milk price received and also what it would have been without the Compact premiums.

I think members of the Commission and the public at large can feel proud of these results. In 2000, when market prices fell nearly \$2.00 per cwt., the Compact premium made the difference and kept the net pay price somewhat above breakeven for the average New England producer. In the absence of the Compact, the average New England producer would have had a significant cash flow deficit last year.

Conversely, in 1998 and 1999 when national market prices were relatively strong, the Compact premiums were much smaller. This demonstrated the “income safety net” concept that many of us have talked about for years: blunting the impact of the tough price years, while getting out of the way of the market in the good price years.

The obvious next question is whether Compact premiums are unduly enhancing the returns earned by the average New England dairy farmer. The best tool for evaluating this is Return on Equity: the average rate that a farmer earns on his/her own investment in the dairy business. Please see Figure 2. The results here are pretty self-explanatory. A 3.3% return on equity over the past 6 years isn’t very exciting compared to stock market returns, most mutual funds or money market accounts. In fact it’s right in there with what you and I can earn by simply depositing our funds in our local bank and doing nothing more. Again, these results illustrate the safety net aspect of the Compact as it was not intended to provide an exciting return on equity for dairy producers.

The 1997 implementation of the Compact was most timely and fortuitous for our industry in Massachusetts. There have been strong pressures and incentives for dairy farmers to exit the business during the past three years:

Tremendous pressure to expand in order to gain further cost efficiencies.

- Very tight farm labor markets that have made procuring and keeping hired labor a major headache.
- Impending environmental regulations for larger farm operations that require substantial investment for compliance without any corresponding economic return.
- Tremendous consolidation within the fluid milk products industry and the disappearance of most traditional locally owned companies.
- Strong dairy cattle prices that made the last few years a good time to “cash in the chips.”
- Strong real estate markets for nonfarm development in southern New England. The Commonwealth’s APR program together with the Compact is a strong combination to keep some of this land from being developed.

A strong labor market, making it attractive for farm owners to exit farming and sell their skills to an employer. The word is out: Former farmers make great employees because of their strong work ethic and diverse skill sets.

All of this makes it exceedingly hard to statistically measure the impact of the Compact. In my judgement, however, it has been a very effective tool in providing a safety net and a clearer investment horizon for New England dairy producers than would have existed without it. While I'm sure we will try, I'm not sure we will ever be able to absolutely quantify the beneficial impact of the Northeast Dairy Compact on producers through statistical means.

I started off by talking about First Pioneer's bread and butter: lending money and providing services to some 9500 individual businesses in our region. I'd like to share how the Northeast Compact affects how we do business with our dairy producers shipping milk to New England markets.

- First Pioneer makes lending decisions on a variety of business factors. Uppermost among these is the profitability of the farm and a specific investment in that farm. To assist our loan officers, we provide internal "outlook letters" on the price of milk to be used in evaluating farm loan decisions. These letters specify one price for the Northeast Compact region, and another for the remainder of our territory. That's a plus for financing new investment for dairy producers in the Compact milkshed.

Risk Management is a real buzzword in American agriculture today. To me, it's a new term for an old concept. That's okay because it is a timeless management concept. The basic premise is that there is lots of unknowns that impact the farm business that are beyond the control of the producer: weather, disease, employee issues, legal liability, the regulatory climate as well as markets and prices. So it is incumbent upon producers to manage this risk, rather than to leave themselves fully exposed. There are lots of tools for managing this risk. I look at the Northeast Dairy Compact as being an important risk management tool that New England consumers, milk producers and elected officials have created. As we have observed, the safety net is working, and that helps our dairy customers better manage risk. That in turn helps us at First Pioneer to make safer loans and to better manage our risk, thereby benefiting all of our farmer-owners.

So our thanks go to the Compact Commission, Commissioner Jay Healy, our supportive New England Congressional delegation and many others who have helped make the Northeast Dairy Compact the success that I believe it is. And thanks for the opportunity to comment at your meeting today.

June 5, 2001

Figure 1  
**Analysis of Cash Margin for New England Dairy Farms**

|   | 1995  | 1996  | 1997                      | 1998  | 1999  | 2000  |
|---|-------|-------|---------------------------|-------|-------|-------|
|   |       |       | <u>(Dollars per cwt.)</u> |       |       |       |
| Milk Price before Compact               | 13.70 | 15.50 | 14.13                     | 15.79 | 15.07 | 13.10 |
| Compact Net Premium                     | 0     | 0     | 0.47                      | 0.25  | 0.49  | 0.91  |
| Net Farm Milk Price                     | 13.70 | 15.50 | 14.60                     | 16.04 | 15.56 | 14.01 |
| Break-Even Milk Price                   | 13.83 | 14.46 | 14.13                     | 13.82 | 14.08 | 13.32 |
| <b>CASH MARGIN</b>                      |       |       |                           |       |       |       |
| w/o Compact                             | -0.13 | 1.04  | 0.00                      | 1.97  | 0.99  | -0.22 |
| with Compact                            | -0.13 | 1.04  | 0.47                      | 2.22  | 1.48  | 0.69  |
| Compact Net Premium as<br>% CASH MARGIN | NA    | NA    | 99%                       | 11%   | 33%   | 131%  |

Note: Cash basis with no return to equity, management or depreciation included.

**Source: *The Northeast Dairy Farm Summary, Northeast Farm Credit Associations, various years.***  
***Special analysis for Northeast Dairy Compact Commission, James Putnam,***  
***First Pioneer Farm Credit, ACA, June 2001.***

Figure

Return on Equity for New England Dairy

|                   | 1995  | 1996 | 1997 | 1998 | 1999 | 2000 |
|-------------------|-------|------|------|------|------|------|
| Return on Equity  | -0.1% | 4.1% | 4.4% | 7.4% | 4.9% | 0%   |
| Average 1995-2000 | 3.6%  |      |      |      |      |      |

Source: The Northeast Dairy Farm Summary, Northeast Farm Credit Associations, various years.

## First Pioneer Farm Credit, ACA Business Profile

---

**President and Chief Executive Officer.** William J. Lipinski, 800-562-2235

**First Pioneer Farm Credit, ACA.** A private sector credit and financial services cooperative owned by its 9,534 customers. A reliable and competitive provider of financial solutions, in good times and bad, to Northeast agriculture. Part of the federally chartered Farm Credit System. We extend approximately \$1.3 billion in credit to capitalize their businesses. These funds help our customers compete in today's challenging business climate.

**We're More Than Just Credit.** We provide a full range of credit services to farmers, fishermen, rural residents and others. We also offer financial services to enhance their business profitability and long-term stability, including record-keeping services, tax services, estate planning, profitability consulting, business transfers, farm payroll service, property appraisals, leasing, credit life insurance and crop insurance.

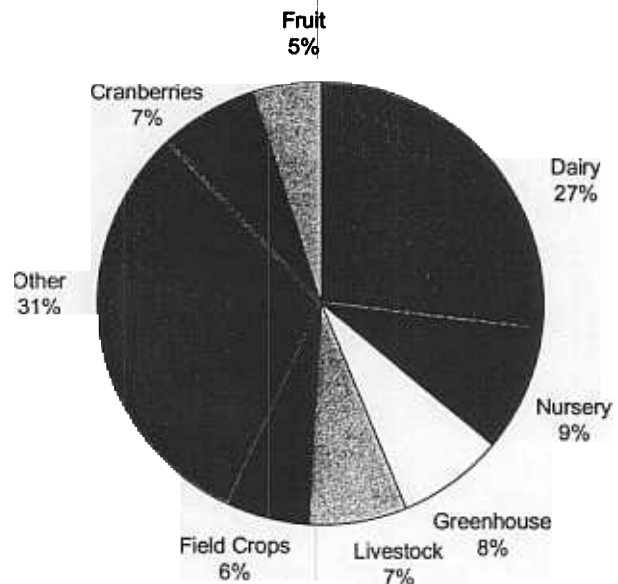
**Dedicated to Customer Value.** First Pioneer's interest rates are very competitive with those charged by other private sector lenders. In early 2001, we returned three-fifths of our 2000 earnings to customers as a patronage dividend. This amounted to \$12.3 million paid to customers, equivalent to a reduction in their average 2000 interest rate of 0.8%.

**Staff of Ag Finance Professionals.** First Pioneer has a team of 215 ag finance specialists working from 15 branch office locations from Cape Cod to the Finger Lakes, and from the St. Lawrence River to Cape May.

**Committed to the Ag Community.** We are especially proud of our programs that help young people enter agricultural careers, such as college scholarships, college student internships and credit and service incentives for young, beginning and small farmers. We also provide financial support to ag programs, such as FFA Star Farmer, New England Green Pastures, the New England Ag Export Showcase, Cornell Dairy Fellows, Century Farm Awards and agricultural leadership programs throughout the region.

**Leading Lender to Northeast Agriculture.** First Pioneer extends credit to all types of Northeast agriculture. We are proud of our 60% share of total credit.

**Loan Portfolio**



**First Pioneer Farm Credit, ACA**  
Your First Choice for Financial Solutions

## How the Northeast Dairy Compact Benefits Northeast Consumers

- 1 Maintains access to fresh, wholesome milk from nearby farms in the Northeast Compact region milkshed.
- 2 Provides a safeguard against the market power of large national milk processing companies and supermarket chains. It is these companies who ultimately have the most impact on the price paid for milk in the store, not dairy farmers or the Northeast Dairy Compact. *National statistics indicate that the dairy farmer received only 37 cents of every dollar spent on bottled milk in 1997. The remaining 63 cents went to processors and retailers who enjoy far greater market power than do dairy farmers.*
3. Keeps the politics out of stabilizing dairy farm incomes in low-price years. The Compact is an on-going counter-cyclical safety net for dairy incomes and our Northeast milk supply.
4. Maintains jobs, tax base and local economic activity here in the Northeast. This includes everything from the nearby bottling plant that processes the milk, to the trucker who moves it from farm to bottling plant to store, to the entire dairy farm business support network for milk marketing, feed/supplies and credit.
5. Farmers are indeed the original environmentalists. Land in dairy farming is a very significant variable in the environmental equation in certain parts of the rural Northeast in terms of open space, wildlife habitat and recycling of carbon dioxide from the atmosphere.
6. Northeast dairy farmers operate on a very tight margin. In the 1996-2000 period, the average Northeast dairy farmer earned 4.9% on his equity invested in the farm business...far less and at greater risk than many other alternatives for investing his/her equity. The average Northeast dairy farmer earned \$13 per hour for a "job" that demands 24-hour responsibility 365 days a year with no conventional benefits such as those enjoyed by most employees. (Source: 2000 Northeast Dairy Farm Summary, Northeast Farm Credit, forthcoming.)
7. "Sends a message" to the dairy farming community, and indeed all farmers, that they are a valued part of the Northeast community and quality of life. As a group, dairy farmers do not earn a high monetary standard of living. *The Northeast Compact has become a highly visible community commitment to the 4.6 million acres of open space and thousands of jobs provided by our region's dairy farmers.*

---

### The Northeast Farm Credit Associations

---

Contact Person: Bob Smith, Northeast Farm Credit, P.O Box 9061, Springfield, MA 01102 (413-821-0212)  
 Source: Jim Putnam, First Pioneer Farm Credit, ACA May 01