TESTIMONY OF
ROBERT D. WELLINGTON
SR. VICE PRESIDENT
AGRI-MARK DAIRY COOPERATIVE
ON BEHALF OF THE ASSOCIATION OF
DAIRY COOPERATIVES IN THE NORTHEAST

DECEMBER 11, 2006
PITTSBURGH, PA

My name is Robert D. Wellington. I serve as senior vice-president for economics, communications and legislative affairs for Agri-Mark dairy cooperative. I have worked in that position for Agri-Mark for the last seventeen years. Prior to that I was employed by the Office of the Market Administrator, New York-New Jersey Milk Market area for eleven years. My position with the Market Administrator's office included senior economist and chief of research and cooperative relations.

Agri-Mark is a Capper-Volstead cooperative headquartered in Methuen, Massachusetts. We have approximately 1450 members located in the six New England states and New York. We market about 2.7 billion pounds of milk annually. Our members own and operate four manufacturing plants including dedicated cheese plants in Chateaugay, New York, and Middlebury, Vermont, a cheese and other dairy product plant in Cabot, Vermont and a butter and powder plant in West Springfield, Massachusetts.

I am testifying here today in support of proposals 1–5 put forward by the National Milk Producers Federation. This testimony is given on behalf of the Association of Dairy Cooperatives of the Northeast (ADCNE). ADCNE consists of the following Capper-Volstead cooperatives: Agri-Mark, Inc., Dairy Farmers of America, Inc., Dairylea Cooperative Inc., Land O' Lakes, Inc., Maryland and Virginia Milk Producers Cooperative Association, Inc., O-AT-KA Milk Products Cooperative, Inc., St. Albans Cooperative Creamery, Inc., and Upstate Niagara Cooperative, Inc. These organizations represent more than 65 % of the milk pooled in the Federal Order No. 1.

Exhibit 28
Witness
Date Rptr.
Powers Garrison & Hughes

MAKE ALLOWANCE CHANGES AND DAIRY FARM COSTS IN 2007

The Secretary has recently recognized cost increases which have been experienced by manufacturers of Class III and IV products in the emergency decision which we hope will be effective in early 2007. This will have the immediate effect of reducing the price of all classes of milk in the federal order system at a time when dairy farmers are experiencing some of the most severe cost-price pressure in many years. We recognize that these adjustments in Class III and IV make allowances were necessary to maintain local outlets for producer milk; but it is now critically important to look at our federal order prices and make necessary and appropriate adjustments to the price formulas to account for increased costs on our dairy farms.

It cannot be disputed that all of the factors recognized in the manufacturing make allowance changes also impact farm costs: energy inflation is a particularly pervasive cost element at the farm level impacting the costs of all purchased inputs, including utilities, fuel, fertilizer and other costs. In the northeast, the cash costs of production are well-tracked by Northeast Farm Credit and some of that data was presented separately by Scott Herring, the witness for that organization. The majority of the ADCNE cooperatives have membership represented in the Northeast Farm Credit database. Roger Cryan has reviewed USDA cost of production data from the national perspective. These sets of data show one undeniable fact: The cost of producing milk on our dairy farms has increased materially since the current federal order prices were set in the federal order reform process. These cost changes must be recognized in the federal order class prices.

The prices of economic inputs used in the dairy industry have risen thereby increasing costs for plants that manufacture Class III and IV products, for suppliers of Class I and II milk, and for farms which produce the milk needed for all plants. The make allowance hearing has attempted to address these costs associated with manufacturing. This was needed so that those plants can more likely cover their increased costs, stay in business, and thereby provide local outlets for farm milk. Dairy farms must be treated with the same measure of concern if they are to stay in business. The Class I price base needs to reflect appropriate cost increases which have occurred since the current level was established.

The NMPF Proposals and Order 1

The National Milk proposals are thoughtfully crafted to build upon the federal order reform decisions. The proposals account for and update the elements of the Class I and II price formulas which are built upon production and marketing cost factors related to the Class I and II markets. These factors are particularly important in the northeast where Federal Order 1 is the largest market in the federal order system for both Class I and II utilization, representing 24% and 31% of the Class I and II volumes in the federal order system in 2005. As such, appropriate Class I and II price mover formulas are critical in the northeast.

The costs of servicing the more than 10 billion pounds of Class I and nearly 5 billion pounds of Class II usage in Order 1 have clearly increased in the past 10 years. Those cost increases are borne by the dairy farmers and their cooperatives in Order 1 and those costs must be reflected in the Class price formulas. The cost of farm to market hauling is just one obvious element of the increased cost to supply Class I and II markets. The average charge to producers in the Northeast Farm Credit data from 1996 to 2006 has increased more than 60% from $.54 to $.87 per cwt. This number does not reflect the full cost of farm to plant hauling because some portion of those costs are underwritten by cooperatives in many cases.

The cost of farm to plant hauling has increased not only because of fuel costs, but also because of plant consolidations. These consolidations have allowed handlers to capture economies of scale, but lead to additional expense of their suppliers who have longer average farm to plant hauls.

All of the costs of organizational overhead associated with supplying the needs of our Class I and II customers have also increased in the last 10 years.

In sum, supplying the Class I and II needs of the market costs more today than it did when the current Class I and II movers were formulated. As costs were recognized at that time, they should be recognized now through adoption of Proposals 1 through 5.

Comment on Regional Impact

We are well aware that changes in the Class I and II movers do not have the same impact on all producers, and all regions. Regional impact differences occur with all, or nearly all, dairy programs. For instance, the MILC program has had a significantly greater regional impact in the upper midwest than in many other regions of the country. Likewise, the changes in make allowances will impact each order, and different producer groups, somewhat differently. But, in each case, the MILC program and the make allowance changes, the policies are correct policies, in spite of differences in regional impact. The same applies to these proposals: They are proper and justified changes in the federal order price formulas and should not be stymied by regional interests.

Comment on Class I/II Premiums

Some may argue that there should not be any changes to Class I and II prices because there are over-order premiums in the marketplace which supposedly account for the costs of supplying the market. The truth is that with the current support price program, and the minimum pricing philosophy of federal orders, premiums are no longer merely "service charges" as may have been the case several decades ago in some markets. In today's marketplace premiums are a necessary part of the price of milk and will continue to be such. An increasing proportion of over-order premiums are being used to pay producers, leaving even less to cover the costs.

Comment on Balancing Costs

The federal order reform decision, and the NMPF testimony, recognizes an element of market balancing in the Class I/II price formulas. It is critical that the record note two important qualifiers to balancing costs: First, not all costs of balancing markets are included in the basic price mover. Second, not all market participants share equally in the costs of servicing the markets, although the balancing cost embedded in the mover is shared equally by all in the pool's blend price. That cost is an intrinsic part of the value of Class I and II milk and should be included in its price. In doing so, the total order pool value is increased. Perhaps at some later time, market service payments can be considered so that the increased value can be more closely targeted to those who specifically provide the services. In the meantime, at least that value is being captured and used to help dairy farmers.

Comment on Emergency Conditions and Proceeding

For the same reasons that the make allowance hearing was considered an emergency and handled on an interim final decision basis, these costs effect the livelihood of producers. For example, more than 5% of Agri-Mark members have gone out of business in 2006 alone. As we speak to these dairy farmers, almost all cite the cost-price squeeze as the reason. We submit that the record in this hearing of current farm level economics could not depict the need for expedited administrative procedures more clearly.

Conclusion

In conclusion, the ADCNE cooperatives, as the dominant suppliers to the largest Class I and II market in the federal order system, endorse proposals 1 to 5 and the testimony of Roger Cryan for NMPF in support of those proposals. We thank the Secretary for holding this hearing and urge the promptest possible implementation of these proposals.