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UNITED STATES DEPARTMENT OF AGRICULTURE BEFORE THE SECRETARY OF AGRICULTURE

In re: Docket No. DA-07-03 (Milk in the Appalachian, Southeast, and Florida milk Marketing Orders)

POST -HEARING BRIEF OF THE MILK INDUSTRY FOUNDATION

Introduction

This post hearing brief is submitted on behalf of the Milk Industry Foundation (MIF). MIF's 115 member companies process, distribute, and market approximately 85% of the U.S fluid milk, cultured products, soft cheeses, eggnog, and creams. MIF submitted its comments regarding the proposals 1, 2, and 3 at the hearing. The main points of that testimony were:

1) the changes aren't necessary; 2) the FMMO system is the wrong policy tool for the problems identified; 3) Class I differentials cannot be altered for one region of the country without disrupting milk marketing in other regions; and 4) these proposals will hurt Class I sales. Additionally, the situation with respect to Class I differentials in the Appalachian, Southeast, and Florida milk marketing areas does not warrant emergency status for this decision making.

It should be made clear that MIF and each of the member companies who testified at the hearing are aware of and sympathetic to the fact of declining milk production in the Southeast region of the United States. This is undeniable in statistics cited by many dairy producers' and their representatives' testimony. But, for reasons noted later in this brief, the fact of declining milk production in the Southeast is not a sufficient basis for adoption of proposals 1, 2, or 3.

These proposed changes are not necessary.

As MIF testified- the key purpose of the FMMO system is to ensure an adequate supply of milk for Class I needs (Tr pg 457). No witness testified at the hearing on the inability to procure milk for class I needs. The key witness for the proponents even conceded that he knew of no periods when the Southeast has gone short of milk (Tr pg 207). In a survey before the hearing, no MIF member indicated they were having trouble securing milk for Class I needs in the Appalachian, Southeast, or Florida marketing areas (Tr pg 457). In addition, the question was put straightforward to one of the processors, who answered quite clearly that his company was not having difficulty procuring milk (Tr pg 472-473). When milk from the local area is not available, the Class I plant looks to more distant milksheds to supplement its needs.

One tool the Class I plant employs to bring in milk is the over-order premium. One argument for the higher Class I differentials was that transportation costs, one factor in determining Class I differentials, have increased. But the hearing transcript includes testimony that higher fuel costs are already being added to the over-order premiums (Tr pg 372).

Some of the witnesses were open about the participation of their farm and cooperative in the Cooperatives Working Together (CWT) program that pays money to producers to entice them to take their herd out of production (Tr pgs 337-338 and Tr pgs 413-414). Part of testimony of these witnesses indicated that CWT ensures that cows are taken out of production in all regions of the country, including the Southeast; they even mention knowing some of the farms that exited through the program. This seems a very curious activity by people truly concerned about having enough milk on hand to supply local needs.

The Federal Order system remains the wrong policy option.

Many references were made in statements and during examination of witnesses to the link between poor prices (relative to what was felt is needed to overcome the competitive disadvantages to producing milk in the Southeast) and the decline in milk production seen in this region. Laws of economics tell us that production will flourish and a market will become dominated by areas with a competitive advantage in production.

The Federal Orders are concerned with marketing milk. They provide economic incentives to move milk to consumers by first satisfying Class I needs, then filling the pipeline for other manufactured products. But these regulations begin with milk after it has been produced. If the Secretary deems there is a need to counter the natural progression of economic realities at the point milk production, he has other, more effective, policy tools available (Tr pg 459-460).

Class I differentials cannot be changed in one region of the country without affecting milk marketing in another.

The current structure of Class I location differentials has been in place, with only minor adjustments, since 1985. For 22 years a competitive balance has existed not only throughout the Southeast, but between the Southeast and plants just outside or even more distant from the boundaries of the Appalachian, Southeast, and Florida milk marketing orders. Over those years, milk bottlers have made significant investments in plants and equipment, based on the natural movement of milk under this competitive balance (Tr pg 439).

Witnesses provided specific examples of plants that will be disadvantaged in the marketplace solely because of the increase in the Class I differential it will be charged relative to the Class I differential of its competitors (Tr pg 437-439; Tr pg 471-476; Tr pg 479-482; Exhibit 36). A penny or even a half-penny difference in cost per gallon can lose a plant some customers and 2.5 cents is enough to lose a supermarket account (Tr pg 481-482 and Tr pg 454). Therefore, increasing differentials by only 10 cents ($0.0086 per gallon) can yield dire results for a Class I plant.

These were specific examples of the unintended consequences that Proposals 1, 2, and 3 will bring to the Appalachian, Southeast, and Florida milk marketing orders. Among the other potential effects of these proposals were plants very distant to the Southeast becoming associated with the one of the orders due to differences between transportation costs and inflated Class I differentials. Plants outside the Southeast may be able to take milk sales from plants within the Southeast, even deeper within the region than the more obvious border counties (Tr pg 266-267; Tr pg 446; Tr pg 450-510; Exhibit 36; Tr pg 523; Tr pg 538-46; Tr pg 573-574; Tr pg 604 -609). All of these consequences, actual and potential, need to be reviewed and analyzed through a comprehensive study of the national system of Class I differentials. In addition, testimony points out that a comprehensive study would calculate shadow prices, the marginal value of moving one more hundredweight of milk. This method allows milk to 'flow' in analysis until a competitive balance has been achieved (Tr pg 226-227).

These proposals will discourage Class I sales.

Another benefit gained by a comprehensive study of Class I differentials is that effects on demand for packed milk products can be included. Raising costs to Class I plants is likely to result in increased wholesale and retail prices. How much will be determined by competitive factors, but any increase in retail price is going to have a detrimental effect on Class I sales in the region (Tr pg 463). One of the conditions for these proposals was that population and Class I sales are growing in the Southeast (Tr pg 78). Raising prices and discouraging sales is not the way to maintain this trend.

There is no emergency.

As stated earlier in this brief, the conditions warranting changes to the Class I differentials do not exist. Therefore, there cannot be an emergency situation (Tr pg 475 and Tr pg 446). The unintended consequences these proposals would and could cause strongly suggest that further study is necessary (Tr pg 593). Years of analysis accompanied the implementation of the current differential structure both originally (1985) and again with order reform (2000) (Tr pg 460-461). The same should accompany any future change. One surprising bit of testimony was when a proponent offered as reason for making an emergency decision "... that waiting for a national review may or may not yield any changes..." (Tr pg 165). When the proponents concede that these changes are so dubious that further review may negate then, the case against an emergency decision must be conceded as well.

Summary

USDA should reject proposals 1, 2, and 3. The proponents have argued that declining milk production in the region and rising fuel costs are proof that Class I differentials should be raised. But production in this region has been trending down for years, due to natural competitive disadvantages to producing milk in the Southeast. Further, some of the proponents are even participating in an organized effort to incentivize the removal of milk production from this region. The proponents have not demonstrated that any Class I plant is experiencing difficulties in procuring sufficient quantities for its needs.

The proponents ignore the fact that the FMMO system is not designed to prop up farm prices and that these changes will discourage Class I sales. Changing the Class I differentials in only one portion of the country will create new incentives for moving milk and creating uncompetitive situations for all plants in the region and many outside it. Such change needs to be reviewed carefully.

Given these shortcomings in the case made for these proposals, and the need to more fully understand their consequences, there is not an emergency situation to be decided.

Respectively Submitted

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