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Testimony of John Rutherford
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International Dairy Foods Association
Federal Milk Marketing Order Hearing
Docket No. DA-07-03

My name is John Rutherford. I have worked for the International Dairy Foods Association (IDFA) for nearly 7 years, and currently serve as a Senior Economic Research Analyst, where I conduct analyses of economic policies and dairy markets. The Milk Industry Foundation (MIF) is a constituent organization of IDFA. The 115 member companies of MIF process, distribute, and market approximately 85 percent of U.S. fluid milk, yogurts, cottage cheese, sour cream, soft cheeses, eggnog, creams, dairy dressing and dips.

I am appearing today on behalf of MIF to voice opposition to the portions of Proposals 1, 2, and 3 of the hearing notice which seek adjustments to the Class I differentials for many, if not all, of the counties in the Appalachian, Southeast, and Florida milk marketing areas. In addition, proponents ask USDA for consideration on an emergency basis. For the reasons to follow, MIF is opposed to all of the increases in differentials contained in these proposals and strongly disagrees that an emergency situation exists.

1. These proposed changes are not necessary.

The key purpose of the Federal Milk Marketing Order (FMMO) system is to ensure an adequate supply of milk for Class I needs. Before making a change to these orders, USDA must determine that an adequate supply of milk could not be found to supply

Class I needs in the Appalachian, Southeast, and Florida marketing areas. I believe you will find this not to be the case. MIF has many members doing business in and around these three marketing areas. None of the MIF members responding to our survey about this hearing indicated they are having trouble obtaining an adequate supply of milk for these areas.

To be sure, there are periods when it is necessary to source milk from more distant locations, but this has been the case for many years is these marketing areas. When milk is brought in, its price will be at least the FMMO minimum, but may very well include additional charges, or over-order premiums, to compensate the seller for giving up that milk. This over-order money is paid to the entity supplying the additional milk and *affects only the milk supplied.*

2. The Federal Order system is the wrong policy option.

The proponents cite declining milk production in the southeast as evidence that the differentials in that Order should be raised. For a couple reasons, this fact should not even be considered. One reason is that when milk is needed, and only at that time, it is identified, purchased, and transported to the plant where it is needed. For USDA to consider whether or not a problem exists in obtaining sufficient milk for Class I needs, the question is not the location of the source, but rather is milk of any origin available for those Class I plants.

There is no question that milk production has been declining over many years in the states which are part of the Appalachian, Southeast, and Florida marketing areas. But we have a national market, meaning milk is available to move across states and regions. A reduction in local production does not necessarily mean a short supply if milk from a more distant location is readily available to replace it

The second reason for looking past decreasing milk production in a specific region is the false implication that Federal Order regulations are appropriate tools for addressing that issue. Lloyd Day, Administrator of the Agricultural Marketing Service, speaking recently before the House Committee on Agriculture's Subcommittee on Livestock, Dairy, and Poultry stated very clearly,"...the marketing order program is not a price or income support program..." He adds, "USDA operates the Milk Price Support Program and the Milk Income Loss Contract (MILC) for price and income support purposes." The Federal Orders are not the policy outlet for any group seeking to alter broad-based structural changes in regional milk production due to the underlying economics of producing milk in any one region.

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

It is important for USDA to remember that ours is a national market for milk. Farm milk can be transported over large distances before processing. Manufactured dairy products, whose values form the basis for Federal order regulated minimum milk prices, are sold all over the country and, indeed, the world. Fluid milk is bottled in larger plants, distributed over wider areas, and generally has a longer shelf-life than even ten years ago.

The Class I differentials used to determine minimum prices paid by plants reflect this national market. Every differential must -- repeat must -- align with the market reality of sourcing milk for that specific location versus that marketed in the neighboring states and regions. The lengthy process of creating the differentials to be adopted during the Federal Order reform process implemented on January 1, 2001 involved years of study and debate among a number of market participants, consultants, and academics over alternatives for the structure of the current differentials.

The changes proposed for this hearing violate almost every aspect of this prior spirit of study and analysis. The most obvious is that the fact of a national market has been left aside for the arbitrary selection of these three marketing areas. These changes will alter the competitive relationships that exist between various plant locations within and outside of these orders. The most egregious of these impacts will be along the outside boundaries of these orders taken as a whole.

Historical market factors have led to the structure of Class I plants at their current locations. Analysis of differentials on a national scope would include these factors and propose changes that would reflect and compliment the current relationships. In fact, if a problem really existed, the proposed changes should be correcting them. But as already noted, MIF members have not had a problem sourcing a sufficient supply of milk for Class I needs in these three marketing areas. In addition, as MIF members will testify to with specific examples, these changes *create* problems by significantly altering price relationships and interfering with markets that have coexisted for years.

4. These proposals will discourage Class I sales.

The proposed changes to the Class I differentials will be detrimental to Class I sales volumes for processors within these regions. As stated above, milk is moved from more distant production areas only when it is needed for Class I use. The additional costs enticing the seller to give up that milk and get it to the plant are the only incremental costs in the system. If the differentials are raised, all Class I plants at all locations throughout these orders will be forced to pay more for all milk used in Class I all the time. Remember, increasing the differentials by as much as $1.70/cwt. means adding $0.147 to the cost per gallon of milk. But any increase in Class I differentials means additional costs for milk.

I am not aware of any study of fluid milk sales that does not find a decline sales volume when prices rise. Per capita consumption of fluid milk has been declining for many years and these changes will add pressure to accelerate that trend. Even though ensuring an adequate supply of milk for Class I needs is an objective of the Federal Orders, USDA should consider if achieving this goal is worth accomplishing at the expense of suppressing Class I sales.

5. There is no emergency.

I stated this earlier but I will reiterate that MIF member company plants are not having trouble obtaining an adequate supply of milk for Class I needs in the Appalachian, Southeast, and Florida marketing areas. Because there is an adequate supply readily available, there obviously is no emergency. Remember, it is producers/cooperatives who are seeking these increases, not the companies that actually buy milk to supply the Class I products for these markets.

Summary

A key purpose of the federal orders is to ensure an adequate supply of milk to satisfy Class I needs. It is not about promoting milk production or supporting farm milk income in any specific region of the country. While the proponents return to the theme of eroding milk production in the southeast and the need, through various aspects of these proposals, to increase milk prices, they offer no evidence that an adequate supply of milk cannot be obtained.

Class I differentials can not be selectively altered without disrupting the existing relationships in the marketplace. USDA should require a comprehensive analysis of the national market before considering increases to any Class I differentials. In addition, these proposed changes will discourage sales of the very products they are intending to supply. The consequence of reduced fluid milk sales volume is another example of the scope of analysis that should be undertaken when considering changes to differentials. The changes to Class I differentials in Proposals 1, 2, and 3 should not be adopted by USDA. And it almost goes without saying, but I will once more, that this hearing should not be considered on an emergency basis.