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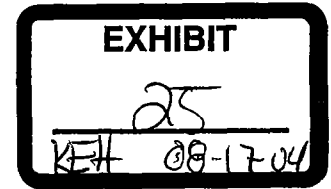
Testimony of Dairy Farmers of America

Milk in the Upper Midwest Marketing Areas

Docket Number AO-361-A39; DA-04-03

Minneapolis Minnesota

August 16, 2004



Dairy Farmers of America

Dairy Farmers of America, Inc. (DFA) is a qualified Capper-Volstead cooperative that represents 13,445 farms located in 47 states. In 2003 DFA marketed 56.5 billion pounds of milk of its member owners, for other cooperatives and for non-member dairy farmers. Our primary market is selling bulk milk to other milk processors.

We support the Federal Order system because we believe it is the most fair and equitable manner to market dairy farmer's milk that will insure them of a reasonable price and common terms of trade. We have participated in nine Federal Order hearings and several subsequent court proceedings since the implementation of Federal Order Reform, in an effort to make Federal Orders function the best way possible for dairy farmers. This is why we are here today to participate in this hearing.

We pool milk on Federal Order 30. We are appearing here in coordination with the other proponents of Proposal 2 - Cass Clay Creamery, Inc., Land O' Lakes, Inc., Manitowoc Milk Producers Cooperative, Mid-West Dairymen's Company, Milwaukee Cooperative Milk

Producers, Plainview Milk Producers Cooperative, Swiss Valley Farms Company, Westby Cooperative Creamery and Woodstock Progressive Milk Producers Association.

We agree that the issues of better defining the performance standards for milk that is located so far from the market that it can never be a regular supplier to the market and providing a solution to the depooling issue are important problems to solve in Federal Order 30. We note that nearly all participants in the hearing support tightening the performance standards for distant milk and most support an elimination or reduction in the ability to depool. We also note for the record that we participate in both activities in an effort to have sufficient revenue streams to pay our members milk prices equivalent to that of our competitors. While we feel both practices need to be corrected in some way we cannot disregard day-to-day impact of the revenue stream in our business operations.

Our management and Board of Directors at both the Corporate and Area Council level have reviewed the issues that will be discussed at this hearing. We have also reviewed the issues in several member communications with the entire DFA membership. We support Proposal 2 as the best solution to remedy the problems.

Discussion of DFA Exhibits 1 - 2

Exhibit 1 Freight Mileage / Return Tables

Exhibit 1 is composed of 9 tables. Tables 1 thru 8 are similar constructs and Table 9 a summary. The purpose of this exhibit is to show the economic results obtainable from attaching milk produced in Idaho to the Order 30 pool under various pooling and classification alternatives.

All alternatives have the following identical assumptions:

- 1) The comparison is for a hypothetical 1,000,000 pound producer;
- 2) The distance from Twin Falls Idaho to Minneapolis is 1,283 miles;
- 3) The haul volume is assumed to be 47,500 pounds;
- 4) The haul rate is based on \$2.10 per loaded mile;
- 5) The haul cost calculation includes the benefit of 400 miles of transportation credit from the Order 30 pool as currently allowed.
- 6) The PPD calculation is reduced by 20 cents to reflect the \$1.80 versus \$1.60 difference in location adjustment between the Order 30 base zone and Twin Falls county Idaho;
- 7) The time period covers the 54 months between January 2000 and June 2004;
- 8) No consideration is given for a "pooling fee" arrangement.

The scenarios vary as follows:

- 1) Assume "once and done" touch base, pool every month and a CIII PPD;
- 2) Assume "10%" touch base, pool every month and a Class III PPD;
- 3) Assume "once and done" touch base, depool the maximum amount when the PPD is negative and a CIII PPD;
- 4) Assume "10%" touch base, depool the maximum amount when the PPD is negative and Class a III PPD;
- 5) Assume "once and done" touch base, pool every month and a CIV PPD;
- 6) Assume "10%" touch base, pool every month and a Class IV PPD;
- 7) Assume "once and done" touch base, depool the maximum amount when the PPD is negative and a CIV PPD;
- 8) Assume "10%" touch base, depool the maximum amount when the PPD is negative and a Class IV PPD;

The calculations show that if the milk were to deliver every day to meet the market demand it would never ship because the return (column I and II in each of tables 1 thru 8) would be

negative. This is totally logical since the haul is \$5.44 per cwt and the PPD is never larger than \$1.23 per cwt.

However if one considers the "once and done" touch base situation (current Order 30 provisions) the return is very attractive totaling \$79,018 or an average of \$0.146/cwt for pooling in each of the 54 months. (Table 1) Whenever the distant milk must perform based on its' own deliveries and at the 10% standard that other milk performs, it would never pool because the return would be negative – \$212,767 or an average of -\$0.394 / cwt. (Table 2)

When the option to "depool at will" is factored into the equation the "once and done" calculation is even more lucrative, totaling \$194,418 or an average of \$0.423 / cwt for the 46 months of positive PPD's only. (Table 3) When "depool at will" is combined with the 10% shipping standard the result remains negative at -\$53,875 or an average of -\$0.117 / cwt. (Table 4)

Shifting the comparison to a PPD driven by a Class IV utilization the "once and done" pool every month return is \$31,018 or an average of \$0.057 / cwt for the 54 month period, reflecting the many months early in the period when Class IV prices were very high. (Table 5) Retaining the Class IV PPD calculation and combining it with a 10% shipping standard the return and pooling every month yields a -\$260,767 or an average of -\$0.483 / cwt. (Table 6)

Finally, retaining the Class IV PPD calculation a "once and done" and "depool at will" ability yields the most profitable return of \$302,100 or an average of \$1.079 / cwt. Year to date 2004 the monthly gain from this strategy would return a average of \$1.992 / cwt gain. (Table 7) Requiring this supply (Class IV PPD and "once and done" and "depool at will") to deliver at the 10% shipping rate would still yield a positive return for the 28 months of positive PPD's of \$149,880 or an average of \$0.535 / cwt. (Table 8)

The conclusions drawn from these tables would be that:

- 1) If milk from Idaho delivered to the Order 30 fluid market every day it would never choose to be a market supplier.
- 2) If the distant milk supply is able to continue to access the market via the "once and done" touch base requirement it will continue to draw funds away from the pool at a large rate. Yet this milk will not ever become a regular supplier because it is too far away.
- 3) If the distant milk is required to perform on its' own merit (ship at the 10% rate) it will likely not choose to pool on Order 30.
- 4) Anytime the milk can "depool at will" the return potential increases dramatically. Thus without addressing both problems together the prospects for improved returns for local regular market suppliers are limited.
- 5) To the extent the distant milk supply is Class IV based at 2003/4 price relationships it may continue to pool on Order 30.

Order provisions should bear resemblance to real world economic consequences. Current provisions yield results that are too far from actual economic reality to be effective and equitable. The provisions should be changed. Proposal 2 is a reasonable way to correct the current inadequate performance provisions.

Exhibit 2 Location Economics and Location Adjustments for the Indianapolis Marketing Area - 1961

The Von Thunen Theorem is a theoretical construct for describing the relationship between production costs, market price and transportation costs. The most productive activities or those with the highest transport costs are located the closest to the market. Conversely, activities that have lower transport costs are located further away from the market. While there are many classroom explanations it is frequently described using agricultural examples.

In the case of a dairy farmer Von Thunen would say that on farm profit would be defined by market price less the cost of production less the transport cost to the market. For Federal Order pricing this is the under pinning logic for having market prices vary by transport costs. That is milk supplies located closer to the market have a higher value than supplies located further away. Location adjustments accomplish that purpose. They attempt to recognize that milk has a value depending on its' relative distance to the market.

When there is not a commensurate price adjustment between the supply location and the demand point in a Federal Order the other factors of the value sharing mechanism of the Order need to be adjusted to recognize the still existing economic reality of location value.

The *Decision on Proposed Marketing Agreement and Order for the Indianapolis Marketing Area* published in the January 5, 1961 Federal Register explains the rationale and logic for the institution of location adjustments and "zone outs" in the promulgation of the Indianapolis Order. We call attention to this Decision because the logic presented is a good description of why such adjustments are needed. Simply said there should be some relative adjustment factor to account for the increased distance that a milk supply lies from a market. Note there are no proposals in this hearing for the institution of "zone outs" and we have no intentions to make or support any. That is not our intent.

However, our proposal aims for a similar economic result – a relative relationship between the market return and the distance from the market that a milk supply must travel in order to supply that market.

This decision recognizes:

"A schedule of location differentials should be incorporated in the Order to provide an appropriate adjustment of order prices at the location of any plant from which milk is moved into the marketing area."

The reasons for the need for the price adjustments are:

"Unless provision is made in the order for the application of location differentials, producers delivering milk to plants located at some distance from the marketing area would be paid the same uniform prices as producers delivering to plants in the marketing area.

It is economically more feasible to meet the needs of the market for fluid purposes from those farms or plants nearest the market before bringing in milk from more distant plants. The value of milk to the market for fluid purposes is greater at the location of a plant in the marketing area which packages it for distribution than at a plant from which milk must be moved to the market for Class I use. Recognition in the Order through the medium of a location differential should be given to this difference in value."

The Decision noted that economic theory and practice were common in the marketplace and should be reflected in the Order language:

"It is customary in both regulated and unregulated markets for handlers to pay dairy farmers delivering milk to farther removed from the market a lesser price per hundredweight than is paid to dairy farmers delivering directly to plants in the marketing area. To the extent that this represents a lower price because of the location of the milk, such a difference in value should be recognized under the Order."

Furthermore the Decision noted that "not all location adjustments are created equal" and some should have a variation in scale – reflecting some combination of an absolute difference in value and a relative difference in value.

"Accordingly the Class I price should be reduced by 10 cents for 80 miles and 1.5 cents for each additional 10 miles or fraction thereof with respect to approved milk received at a plant which is not less than 70 miles from Monument Circle in Indianapolis."

Finally, the Decision noted that the above price adjustments, which were for Class I milk should be reflected in prices paid to producers as well and for the same reasons:

"Prices paid producers supplying plants at which location differentials apply should be reduced to reflect the lower value of such milk f.o.b. the point to which delivered."

These points support our contention that there must be a better measure for the relationship of milk value and distance in Federal Order 30. This principle is well grounded in economic theory, a standard practice in Order language and operation and needs attention here as part of the discussion of how best to decide what performance standard should apply in Order 30.