Proposals to Promulgate a Federal Milk Marketing Order for California
Hearing in Clovis, California, October 2015

Statement of John H. Vetne on FMMO policy evolution: Orderly Marketing and Sec. 8c(18) Supply and Demand pricing.

This hearing has presented a good opportunity for industry and agency participants to learn, or to understand better, how government regulation of milk pricing came to be, and how government milk pricing policies have evolved in response to evolution of milk production, milk processing, milk manufacturing, and milk product distribution practices. Dr. Bill Schiek had taken us through a history of the California program. Paul Christ and Dennis Schad have outlined the evolution of parts of the FMMO program. I hope to contribute some additional perspective to the FMMO program from my experience of over 40 years, and USDA literature, including regulatory decisions.

This is important, I believe, so that party presentations and agency deliberations can be measured against expressed policies, and why such policies came to be. And if a departure from policy is desirable, to recognize the departure and explain why a departure is necessary.

Dairy economics literature is also important as a reference and a guide to decision-making reasonableness. The U.S. Secretary of Agriculture, speaking through his Judicial Officer, has explained that milk order promulgation and amendment decisions are properly measured against "the view of the leading experts in the field of dairy marketing.... It is in the light of these views by the leading dairy experts that the Secretary's final decision should be evaluated."[1]

<u>Orderly and Disorderly Marketing of Milk</u>

The AMAA statement of congressional policy, in 7 USC Section 602(~~3~~)(4), allows the Secretary "to establish and maintain such orderly marketing conditions for [milk and other farm products]... as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market...." The terms "orderly"

[1] *In re Borden, Inc.,* 46 Agric. Dec. 1315, 1420 (1987). The *Borden* decision gave particular attention to the Nourse Report – *Report to the Secretary of Agriculture by the Federal Milk Order Study Committee* (USDA, 1962), *Borden* at 1409 - 1416, and to Part I of the Report of the Milk Pricing Advisory Committee, *Milk Pricing Policy and Procedures – Part I, The Milk Pricing Problem,* (USDA, 1972), *Borden* at 1416 – 20. Part II of *Milk Pricing Policy and Procedures – Part II, Alternative Pricing Procedures* (USDA 1973), discusses policy and regulatory options for pricing of Grade A milk without reliance upon Grade B (M-W) competitive prices, since Grade B production was rapidly diminishing. Part II concludes that product price formulas, with product reference prices and make allowances, would be the best option. The Nourse Report is available at available at http://dairy.wisc.edu/pubPod/pubs/Nourse.pdf . *Milk Pricing Policy Part I* can be found at http://dairy.wisc.edu/PubPod/Reference/Library/Knutson,etal.1972.pdf . *Milk Pricing Policy Part II can be found at* http://dairy.wisc.edu/PubPod/Reference/Library/Knutson,etal.03.1973.pdf .

or "disorderly" are not defined, but are explained by historical context and agency decisions for 80 years.

Historical context, and USDA illustration of conditions that may demonstrate disorder sufficient to warrant federal intervention, are summarized in the most recent AMS program brochure entitled "The Federal Milk Marketing Order Program" (Marketing Bulletin No. 27, updated January 1989) ("FMMO Bul. 27). This publication has not been updated in the past 25 years, and is not available on USDA websites, so it is reproduced in Part A of my exhibits. Disorderly milk market early history is summarized in pages 7 - 10,[2] and illustrations of more recent disorderly behavior in unregulated markets that may merit regulatory intervention, or "conditions indicating need for an order," is described in pages 11 – 12 of FMMO Bul. 27.

The application and evolution of USDA policy in identifying and quantifying milk market disorder is shown in its decisions. In my view and experience, USDA has generally applied its policies consistent with the Erba-Novakovic definition of "disorderliness" as "lack of a predictable, sustainable, and efficient flow of a product to a specific market," and lack of "orderly relationship between different markets in terms of price and supply...."[3] That is, an assertion of disorderly or undesirable conditions is demonstrated, if at all, by observable and quantifiable market behavior.

The two most recent milk marketing order promulgation decisions demonstrate this principle. In 1982, a marketing order for southern Idaho and eastern Oregon was created. Proponent cooperatives, given a second chance to prove their case, presented substantial evidence of market behavior that was deemed disorderly.[4] In 1990, a marketing order was promulgated for the Carolinas. This promulgation

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[2] A more detailed history of milk marketing disorder prior to the AMAA, and of USDA's evolving methods to stabilize milk markets through marketing orders, is contained in the "Nourse Report."

[3] Eric M. Erba and Andrew M. Novakovic, *The Evolution of Milk Pricing and Government Intervention in Dairy Markets,* (Cornell Program on Dairy Markets and Policy, E.B. 95-05, Feb. 1995), http://dairy.wisc.edu/pubPod/pubs/EB9505.pdf . USDA's 1972 *Milk Pricing Policy and Procedures* Report (Part I, pages 4-5), explained that "orderliness, in a market context, is the opposite of chaos.... In the long run, it implies prices which achieve a reasonable balance between production and consumption." "It implies the establishment of relations between producers and handlers which facilitate fair, but not disruptive, competition among producers and handlers while encouraging the establishment of reliable channels of trade."

[4] 46 Fed. Reg. 21944 (Apr. 4, 1981) (Final Decision). Idaho-area cooperatives had previously sought a milk marketing order for the region, but USDA recommended against an order because, in the agency's view, the proof offered at the first hearing was insufficient to warrant federal intervention. 44 Fed. Reg. 48128 (1979).

was also supported by evidence of observed and quantified market behavior deemed to be disorderly.[5]

Milk Orders have been regularly amended to promote marketing efficiency, equity among handlers, equity among producers, adequate supplies for fluid use when needed, and efficient disposition of milk in excess of fluid needs to manufacturing plants. Amendments have frequently been needed because the orders themselves created disorderly marketing. For example, during the 1980's and 1990's Grade A milk production was expanding rapidly in markets with pooling standards designed to accommodate smaller pools of milk. To promote for surplus milk marketing efficiency and equitable access to market pools by producers ready, willing and able to supply milk for Class I use, diversion limits and other pool performance standards were often suspended after opportunity to comment, but without a hearing. Amendments, after formal hearing, followed after repeated suspensions. Gradually the orders adjusted to the market reality of larger pools of Grade A milk and occasional imbalance of supply with demand, by giving authority to Market Administrators to adjust pooling standards.

Supply plant rules similarly evolved to promote efficiency. Historically, a supply plant was a place where small quantities of milk from many producers was assembled and transshipped to distributing plants. As farms produced more and more milk, and transportation technology improved, supply plants were allowed to direct-ship milk from producer patron farms to distributing plant customers, thereby enhancing marketing efficiency objectives. A vestige of the historical role of supply plants as a transshipment point is illustrated by the Upper Midwest requirement, as explained by Henry Schaeffer, that supply plant operators are still required to "wet the tank" once per month.

The point of this is that USDA has consistently and reasonably relied upon a proponent of a milk order or order amendment to meet its burden of proof with evidence of market practices that constitute disorder before creating a regulatory remedy. In cases where proponents appeared to rely more on regulatory philosophy than on hard facts, USDA has rejected the proposed rule or order. This is illustrated by the 1979 recommended decision in the first Idaho promulgation hearing, and in the 1989 Texas-Southwest Plains decision denying proposals to regulate large producer-handlers.[6] In the Texas decision, the Secretary agreed that lack of regulated pricing for producer-handlers "raises the potential for competitive inequities among handlers," and that in fact "there is not an equal sharing among all dairy farmers in the market of the returns from the sale of all milk in all uses. **** The existence of large producer-handler operations merely implies that the

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[5] 55 Fed. Reg. 25623 (1990).

[6] 54 Fed. Reg. 27179, 27182-83 (June 28, 1989).

conditions for disruptive and disorderly marketing conditions may exist."[7] Concluding his discussion of the proponents' failure to meet their evidentiary burden, the Secretary explained:

> The justified concern of proponents over the potential for unfair and disorderly marketing conditions has not manifested itself with any demonstrable evidence of disorder in the Texas market. **** Consequently, in view of insufficient evidence of market disorder attributable to producer-handler operations, there is no basis for adopting the proposal to regulate relatively large producer-handlers.[8]

Notably, both in the Idaho market, and in markets with large producer-handlers, proponents offered substantial evidence in subsequent proceedings that met their burden of proof, and the Secretary then granted a milk order remedy.

<u>Remedies Available, and Considerations Required, for Milk Order Rules</u>

If a producer or cooperative or a handler petitions the USDA for a hearing to promulgate a milk order or amendment to cure apparent marketing disorder, what can the department do, and what must it do, if proponents have met their burden of proof as to disorderly conditions?

Section 8c(5) of the AMAA governs marketing orders for milk. The introductory clause says:

> In the case of milk and its products, orders issued pursuant to this section shall contain one or more of the following terms and conditions, and (except as provided in subsection (7)) no others:"

There follows a list of authorized types of milk order rules, including the core principals of uniform classified pricing to handlers based on use, and uniform blend prices to producers regardless of handler use, each subject to certain limited adjustments, in subsections (A) and (B).

In subsection (G) there is an express limitation on some types of trade barriers, as follows:

> (G) No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any production area in the United States.

There is also an express standard for consideration of any milk order provision designed to fix or modify minimum prices to be paid producers. The Secretary must

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7 54 Fed. Reg. at 27182 (1989).
8 54 Fed. Reg. at 27183 (1989).

consider a variety of "economic conditions which affect market supply and demand for milk and its products in the marketing area to which the contemplated agreement, order, or amendment relates...," and then "fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest." 7 U.S.C. Section 608c(18) (emphasis supplied).

The Secretary has expressed his interpretation of this section many times in decisions and in correspondence. In 2008 the Secretary terminated a proceeding to consider higher Class I and II prices requested by NMPF to provide economic relief to dairy farmers,[9] and on several occasions he denied requests for price relief due to conditions of drought and other milk production challenges because the markets had adequate supplies of milk for fluid beverage use, and the AMAA is not intended to be a price support program. Part B of my exhibits, in chronological order, contains some of these letter-determinations by the Secretary. Letters of September 17, 2012, by Secretary Vilsack and AMS Deputy Administrator for Dairy Programs, Dana Coale, contain a concise and thorough explanation of USDA's interpretation of the limits of its milk pricing authority under the AMAA. The Deputy Administrator explained:

> First, the Federal Milk Marketing Order (FMMO) program is not designed to be a price or income support program, since it is not authorized to establish minimum prices above the relative market value of the products of milk. ****
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> Section 608c(18) of the Agricultural Marketing Agreement Act of 1937, as amended, outlines the criteria and procedure by which the Secretary establishes and adjusts minimum prices in the FMMO program.

Examination of local and regional supply and demand conditions in some marketing areas has nevertheless led to increased minimum milk prices since FMMO reform. USDA has twice increased Class I prices in the southeast markets -- to address hurricane-created fluid milk supply difficulties in 2004, and to address declining milk supplies available to a growing population in 2008.[10]

There is one other provision of the AMAA that requires examination of conditions unique to regional marketing and production areas for milk and other commodities. Section 608c(11)(C) states:

> (C) All orders issued under this section which are applicable to the same commodity or product thereof shall, so far as practicable, prescribe such different terms, applicable to different production areas and marketing areas, as the Secretary finds

[9] 73 Fed. Reg. 78917 (Dec. 24, 2008).
[10] 69 Fed. Reg. 67670 (Nov. 19, 2004), and 73 Fed. Reg. 11194 (Feb. 29, 2008).

necessary to give due recognition to the differences in production and marketing of such commodity or product in such areas.

But the Secretary's tasks are not completed even if record evidence is good, proposed rules conform to the limits of Section 8c(5), proposed prices are fixed after thoughtful consideration of Section 8c(18) pricing factors, and unique regional factors are considered. If handlers do not agree to be bound to the terms of a marketing agreement, and for milk orders they never do, the Secretary must determine "that the issuance of such order is the only practical means of advancing the interests of the producers of such commodity [i.e., milk, in this case] pursuant to the declared policy..." and is approved by producers. 7 U.S.C. Section 608c(9)(B) Although the "only practical means" test is expressed at the end of the process, it is something that the agency should bear in mind from the time a petition for hearing is received through the conclusion of decision-making. Application of this standard is reflected in USDA decisions that modify milk order terms requested by proponents and in decisions where USDA, on its own initiative, creates a regulatory remedy that no proponent has asked for.

Several of these provisions present some unique challenges for USDA in addressing the Cooperatives' proposals for a California Milk Marketing Order, and in reconciling the proposed regulatory remedies with express statutory limitations and instructions. The proposals largely disregard Section 608c(18) milk pricing standards, particularly for Class III and IV uses of milk, and they appear to create several barriers to the marketing of milk and dairy products in tension with the limits of Section 608c(5)(G). The proposal to incorporate the California milk quota system as part of a federal milk order plan for distribution of classified price milk revenue to producers unnecessarily creates tension with "uniform" producer price requirements of Section 608c(5)(B).

A Few "Big Picture" Observations About Supply and Demand for Milk and its Products in California – The Marketing Area to Which the Contemplated Order Relates – And in Other U.S. Milk and Milk Product Production Areas

Much data is already in the record concerning the growth of milk production, and of milk products production, in California. Useful visual tools to illustrate dairy growth in California, and dairy endeavors in the rest of the U.S., include U.S. Census of Agriculture Agricultural Atlas maps from the 1997, 2002, 2007 and 2012 census showing the population of milk cows by location.[11] The 2012 map is reproduced in Part C of exhibits.

Another useful visual tool to examine supply and demand for products of milk produced in California, and in the rest of the U.S., and how supply and demand for

[11] See Agriculture Atlas, Livestock and Animals in http://www.agcensus.usda.gov/publications/2012/

these products have changed rather dramatically from 1993 to May 2006, is the product flow to population/demand maps generated by the U.S. Dairy Sector Simulator model. The modeled cheese product flows from California in 1993 and 2006 are reproduced in Part D of exhibits.[12]

The simulated Class III price surface for milk delivered to cheese plants in the 1996 USDSS report, based on 1993 data is contained on page A10 of the report (.pdf page 52), with the nation's lowest pricing points in central California, southern Idaho, and Minnesota, slightly higher prices in Wisconsin.

California's supply of milk and cheese have clearly changed since 1993, and since 2006 – the most recent year with some published cheese marketing results using the USDSS model. Cooperative proponents for a California Federal Milk Marketing Order urge USDA to look no further than 1990's data on supply and demand for milk and milk products, along with 1999 agency evaluation of that data, to reach a decision on appropriate minimum Class III and IV prices for California in 2015 – 2016. It is difficult to imagine how proponents' myopic approach can satisfy Section 8c(18) of the AMAA.

Detailed discussion of reasonable levels for Class III and IV pricing in California, in the event an FMMO is adopted for the state, will come in later testimony.

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[12] James Pratt, Andrew Novakovic, Mark Stephenson, Phil Bishop, and Eric Erba, *U.S. Dairy Sector Simulator, A Spatially Disaggregated Model of the U.S. Dairy Industry* (Cornell Agricultural Economics Staff Paper, No. 96-06, Nov. 1996), product flow map for cheese (.pdf page 47). http://dairy.wisc.edu/pubPod/pubs/SP9606.pdf Chuck Nicholson & Mark Stephenson, *Class I Differentials With $2.50 Fuel to $5.00 Fuel*, powerpoint presentation to Invitational Workshop for Dairy Economists and Policy Analysts, May 5, 2011 (Chicago, Illinois), ppt. .pdf page 20, http://dairy~~matkets~~.org/Workshops/2011Chicago/Presentations/Nicholson.PDF
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