

Testimony
Russell C. Redding, Acting Secretary
Department of Agriculture
Senate Agriculture & Rural Affairs Committee
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Good Afternoon Chairman Brubaker, Chairman O'Pake and distinguished Members of the Senate Agriculture & Rural Affairs Committee. Thank you for the opportunity to discuss the challenges facing the dairy industry and the struggles of our Pennsylvania producers. It is an honor to be here today on behalf of Agriculture Secretary Russell Redding, whom as you know, has been a tremendous advocate for Pennsylvania's dairy farmers. He has been advocating on behalf of our dairy farmers on both the state and federal level, as I will discuss later in my testimony, and will continue to challenge both government and the industry to find a solution to the dairy pricing paradox.

The Pennsylvania dairy industry has been an important part of my life, as I grew up on a family dairy farm in Gettysburg. Years later, my wife and I operated our own dairy –which we refer to as our joint master's degree in reality. I know first hand that it is one thing to read and talk about the dairy crisis and quite another to live off of a milk check.

There have been countless public meetings hosted across the state specific to the dairy crisis over the last several months. I have attended many of them. At these meetings the pain and hardship felt by our state's more than 8,000 dairy farmers has been heard loud and clear. They face financial challenges the likes of which most of us have never experienced.

We have all been impacted by the recent economic downturn and still sluggish economy, but dairy farmers are some of our hardest hit; now approaching the one-year anniversary of selling their milk at a loss.

Never Waste A Crisis

I have found myself frequently using the phrase "never waste a crisis" at many of the recent meetings with policymakers, dairy farmers and allied industry members. By that I mean that now is the time to bring attention to and examine the most intimate details of dairy programs, policies and pricing, not just at the federal level but also right here at home.

We must examine solutions for both the near term and the long run. The immediate crisis is an unprecedented opportunity to develop a dialogue on dairy pricing issues long considered "too complex" or to be matters for the federal government only.

The dairy crisis is undoubtedly a national one in many respects, but we must use this opportunity to bring the best thinking to bear from Pennsylvanians, and break new ground using the tools available in Pennsylvania.

Center for Dairy Excellence

In 2003, Governor Rendell created the Pennsylvania Dairy Task Force and, at the recommendation of the task force, the Center for Dairy Excellence. In recognition that there are many issues impacting the profitability of the dairy industry, the Dairy Task Force and the Center for Dairy Excellence have worked to empower people, create partnerships and coordinate the availability and use of resources to grow Pennsylvania's dairy industry. These combined efforts through such programs as dairy profit teams, business planning

templates and risk management initiatives have helped many dairy families better weather the cyclical nature of this industry.

Actions on Federal Level

Having said that, it may be helpful to recite some of the efforts that Governor Rendell and the Department of Agriculture made in the last several years to engage Pennsylvania's Congressional delegation, the USDA and Secretary of Agriculture Vilsack in discussions and efforts to improve dairy policy and programs at the federal level for the benefit of our Pennsylvania dairy farmers:

- Develop workable, meaningful and affordable risk-management tools like LGM-Dairy Insurance.
- Establish a feed adjustor to the Milk Income Loss Contract (MILC).
- Provide greater transparency on U.S. trade agreements.
- Improve the system of price discovery to ensure dairy farmers know what market factors are considered when determining their price.
- Advocate for the extension of the Milk Income Loss Contract (MILC) program which is administered by USDA and provides payment for roughly 45% of the difference between federal order milk prices and a defined threshold (presently approximately \$17.00 cwt). Milk prices have been well below the threshold for most of the last year. From October 1, 2008 through September 30, 2009, a total of \$68,950,722 was paid to Pennsylvania dairy farmers under the MILC program.

Actions at the State Level

The presence of Pennsylvania in national dairy policy discussions has and will continue to be felt. However, we cannot ask for action and new ways of thinking in Washington without also asking for the same right here in Pennsylvania. Just as we have done in Washington, we need to make sure that we make full use of the authority we have at home.

Pennsylvania is one of a small number of states that have a state system for providing producers price protections from the volatility of the market. The Milk Marketing Law was first enacted in 1937 and we are grateful to have it today. As with many statutes from decades ago, its terms are broad and provide great flexibility. The Pennsylvania Milk Marketing Board (PMMB) has exercised its authority under the statute in various ways over the decades, in efforts to be responsive to changing conditions.

The dairy industry in Pennsylvania in the years leading up to World War II had problems unique to that time which necessitated the passage of the law. The lengthy preamble to the law recites some of those problems in colorful detail. In this present time of crisis, we need to look at every possible solution within the broad parameters of this law and need to squeeze every ounce of authority out of this law to help address the dairy industry's problems, just as our predecessors did in passing the law itself.

The Rendell Administration's efforts to attempt to make the Milk Marketing Law more responsive to changes in market conditions and industry practices did not begin in recent weeks, or even recent months. Our efforts stretch back more than three years; during which time we have experienced both historical highs and today's devastating lows in dairy prices.

Petitions Before the PMMB to Expand Over-Order Premium

Starting in 2006, the Governor and the Department filed two petitions with the PMMB seeking to expand the scope of the current over-order premium to address changing marketing and industry practices.

The current over-order premium is only paid on between 15 -20% of all PA-produced fluid milk, despite the fact that approximately 40-45% of all PA-produced milk is sold as fluid milk. (See Figure 1) The quantity of milk representing the difference between those two numbers (between 20 – 30% of all PA-produced milk) loses qualification for the PMMB's over-order premium because it doesn't meet the three-part test of "produced, processed and sold at retail in PA."

Both petitions sought to include more milk that is produced and processed in Pennsylvania within the scope of the current over-order premium by eliminating in whole or in part the requirement that the milk be retailed in Pennsylvania in order to qualify for the over-order premium.

The first petition was filed in September 2006 and sought the expansion of the over-order premium to eliminate the "retailed in PA" requirement all together. The Board denied the petition in June 2007. However, the Board stated in it's ruling that it would consider a petition to expand the over-order premium to milk sold in states with a mandated over-order producer price, as existing in Pennsylvania. As a practical matter, in terms of the markets into which Pennsylvania dealers retail PA-produced milk, that would mean New Jersey. In 2006, New Jersey instituted for the first time an "over-order" pricing scheme of very modest proportions.

The second petition was filed in July 2007 and sought simply to expand the over-order premium to milk produced in PA, processed in PA but retailed in New Jersey.

After nearly two years, a decision was issued by PMMB in April 2009 denying the petition for this small expansion of the current over-order premium.

The evidence presented from the PMMB's records indicated that this petition, if granted, would have included the equivalent of another 5% of all PA-produced milk within the scope of the current over-order premium. The petition sought to require the equivalent of New Jersey's small over-order premium, \$.65 cwt, be paid on this quantity of milk. (See Figure 1) The net additional payments to PA producers from this modest proposal would have been in excess of \$3,300,000 in additional over-order premium revenues in 2008. The PMMB's decision was made by a 2-1 vote of the 3-member board.

This PMMB's decision in this regard is presently on appeal in the Pennsylvania Commonwealth Court, with oral argument anticipated in March 2010.

On-Going Dialogue with PMMB

As 2009 progressed and the dairy crisis deepened, the Governor wrote to the PMMB on September 15, 2009, requesting an analysis and set of recommendations of what could be done at the state level under authority of the Milk Marketing Law to address the milk price collapse.

On October 14, 2009, the PMMB responded with a detailed narrative of the features and perceived limitations of its present pricing structure and a list of items for consideration.

On November 13, 2009, the Governor responded with essentially two broad areas of inquiry on which further discussions with the PMMB were requested.

“Produced, Processed and Sold” in PA

The first proposal is to re-visit the issues on appeal at the Commonwealth Court, specifically expanding the current over-order premium to include milk that, for one reason or another, does not qualify for the PMMB’s over-order premium due to the “produced, processed and sold at retail in PA” requirements currently applied. As has been the case since 2006, the Office of the Governor and the Department of Agriculture have been trying to address the gap in the PMMB’s pricing to include more of the roughly 20 – 30% of all PA-produced milk utilized as fluid milk but which does not receive the PMMB’s over-order premium. Significant changes benefitting Pennsylvania’s dairy producers may not be possible without addressing this issue.

“Assumed Premium”

The second proposal is to discuss another identified gap in Pennsylvania’s current over-order premium application which results in no return to PA dairy producers. This gap exists as a result of the method of establishing the minimum wholesale price to be paid by retailers for the milk on their shelves and the resulting minimum retail price paid by PA consumers.

It is assumed in the calculation of the minimum wholesale and minimum retail prices that all fluid milk on the retail shelf in Pennsylvania has had the PMMB’s over-order premium paid upon it. The wholesale and retail prices are set accordingly in order to assure the milk dealers a specific allowed profit margin, defined in the Milk Marketing Law as between 2.5 – 3.5%.

The “assumed” payment of the PMMB’s over-order premium is a penny-for-penny pass-through in the retail price of every gallon of milk sold in Pennsylvania; even though the milk dealers do not in fact pay an over-order premium on every gallon on the shelves (due to some importation of out-of-state milk, for example, or the movement of milk which has broken the chain of “produced, processed and sold at retail” in PA).

Therefore, the consumer pays for the application of the over-order premium as a portion of the retail price on every gallon of milk sold in Pennsylvania, yet a large portion of those sales result in no mandated over-order premium being paid to a PA dairy producer. Given this dynamic and in recognition that Section 805 of the Milk Marketing Law states that the benefit of all minimum price increases are to be given to producers, it would be beneficial to review this portion of the law as it does not appear as if this portion of the law is being followed.

The “assumed premium” amount simply becomes an additional item of dealer profit margin, over and above the defined allowed profit set forth in the Milk Marketing Law. This quantity of the retail price that may never be paid to any dairy producer could rightfully be termed an “assumed premium.” (See Figure 2)

In order to determine the amount of “assumed premium” which is being paid by Pennsylvania consumers, but not making its way back to any PA producer, it is necessary to first establish the amount of milk sold at retail in Pennsylvania as fluid milk.

Through consultation with PMMB’s Chief of Enforcement and Accounting, the best number that can be identified by the PMMB to approximate that figure is the amount of milk sold

subject to the minimum wholesale in PA. In 2008, the volume of milk sold in PA subject to the minimum wholesale was 2.326 billion lbs. (2,326,000,000).

According to PMMB staff, in 2008 the volume of milk upon which the PMMB's over-order premium was paid was 1.459 billion lbs. (1,459,000,000). Subtracting this number from 2.326 billion lbs. results in a total of approximately 867 million lbs. (867,000,000) of milk upon which the "assumed premium" was paid by Pennsylvania consumers in 2008 but never paid to a PA dairy producer.

The equation is as follows:

2,326,000,000 lbs of milk sold at PMMB minimum wholesale
- **1,459,000,000** lbs of milk upon which PMMB over-order premium paid

867,000,000 lbs of milk upon which the "assumed premium" was paid by PA consumers but not paid to a PA dairy producer (approx.)

Expressing the "assumed premium" in terms of dollars and cents, would be as follows:

Assuming an over-order premium totaling approximately \$3.00 cwt., as is presently the case, the amount of the minimum retail price that is directly attributable to the PMMB over-order premium is approximately \$.25 per gallon on every gallon retailed in Pennsylvania. On the volume of 867 million lbs. (867,000,000) of milk, or 100,572,000 gallons, that would total approximately \$26,000,000 in additional over-order premium value.

The entire total paid to dairy producers through the PMMB's over-order premium, based upon \$3.00 cwt., would total approximately \$44,000,000.

\$44,000,000 – dollars generated by PMMB's over-order premium

\$26,000,000 – additional value generated from the "assumed premium"

This additional value lost to Pennsylvania dairy producers, but provided by Pennsylvania consumer dollars as part of the retail price of milk, is approximately 60% of the entire amount generated by the PMMB's annually.

In comparison to the roughly \$68,000,000 provided for Pennsylvania producers by the federal government's MILC program, this additional value of \$29,180,000 already generated by Pennsylvania retail sales under a calculation that assumes its payment to Pennsylvania dairy producers is a significant cause for further discussion by policymakers grappling with the dairy crisis on behalf of the citizens of Pennsylvania.

Summary

To ensure that we are exploring all policy options to sustain the Pennsylvania dairy industry, we must aggressively pursue all federal and state actions. Certainly, we are thankful in these difficult times to have the Pennsylvania Milk Marketing Board. It puts us in a separate class of states to have a state pricing mechanism to help our dairy farmers. Now, we must use the full authority of the Milk Marketing Law to benefit more PA producers.

To that end, the most important and immediate task is to create a mechanism that would capture some of the "assumed premium," totaling tens of millions of dollars annually, and requiring its payment or distribution to PA dairy producers, as provided in the Milk

Marketing Law. The Milk Marketing Law provides the ability to do this without any necessary statutory changes.

The details and parameters of the mechanism created for capturing of this premium, and perhaps the relationship that mechanism bears to the "produced, processed and sold" requirements of the current over-order premium, are certainly topics for discussion.

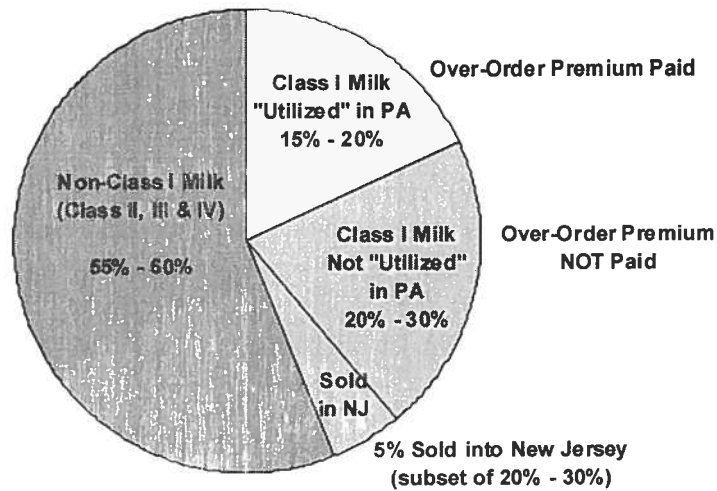
The Milk Marketing Law remains a viable and responsive law that is capable of providing true benefit to Pennsylvania's dairy farmers provided its provisions and the powers and policy-making exercised at the state level is done in a forward-thinking fashion, befitting the opportunity presented by the crisis with which we are presently faced.

The dairy industry is critically important to the economy and quality of life and therefore must be nurtured and supported. Having the right state and federal policies in place will be critical to improving farm income.

Thank you again, Chairman Brubaker, Chairman O'Pake and distinguished Members of this Committee for your willingness to address this issue and for your appreciation of the seriousness of the challenges our dairy farmers are faced with on a daily basis. I look forward to the opportunity to work with you to find solutions to make the PA dairy industry stronger. I am eager to take your questions or address any comments from the Committee today or at any time.

Figure 1 –

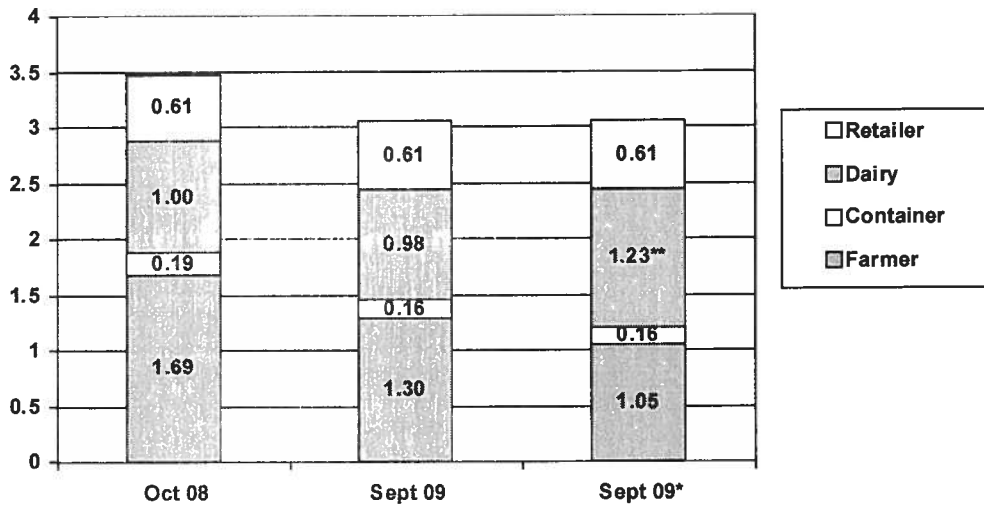
All PA-Produced Milk
Approximation of Utilization Breakdown



"Utilized" = Produced, processed and sold at retail in PA

Figure 2 –

Reduced Fat (2%) Gallon PA Retail Price Breakdown



Source: PMMB 11/2009 except * column added

* Reflects potential breakdown if the Over-Order Premium is not paid to PA producer.

** The \$.25 shift from farmer to milk dealer is the pass-through of the PMMB's Over-Order Premium in the retail price. If the milk is procured from an out-of-state producer, some amount of voluntary premium may be paid but the exact amount retained by the milk dealer varies by transaction. In a transaction where PA-produced milk has left and later re-enters Pennsylvania, the full \$.25 may be retained by the milk dealer and lost by the dairy producer.

The allowed milk dealer profit margin under Milk Marketing Law calculations performed by PMMB is approximately \$.09 per gallon.