

**Statement of Lloyd Day, Administrator
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U.S. Department of Agriculture**

Before the

**House Committee on Agriculture
Subcommittee on Livestock, Dairy, and Poultry
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Mr. Chairman, and members of the Subcommittee, good morning and thank you for the invitation to appear before you today. Accompanying me is Dana Coale, Deputy Administrator, AMS Dairy Programs. My remarks will provide a brief overview of the Federal Milk Marketing Order system including a review of Federal Milk Marketing Order rulemaking procedures.

Dairy Market Situation

Although the dairy industry is facing increasing feed costs, slowed increases in milk production and robust demand are resulting in stronger milk prices. Through February of 2007, estimated U.S. milk production has increased only slightly over 2006. In January and February of this year 29.9 billion pounds of milk were produced, growing just under one percent over the previous year. The most recent estimates show limited increases in cow numbers. The 9.1 million cow herd is just 0.4 percent larger than at the same time last year. Production per cow in February of this year was unchanged from 2006 at 1,567 pounds per cow.

Commercial disappearance of milk in January was estimated at nearly 15 billion pounds, up over 5 percent from 2006. However, with tightening milk supplies,

production of dairy products is already slowing and so far in 2007 production of nonfat dry milk and skim milk powders is falling below 2006 levels. As a result, dairy product prices have been increasing as have milk prices. The average Federal order uniform milk price of \$14.70 per hundredweight reported for February of this year is a year-over-year increase of more than 8 percent.

Internationally, the U.S. has become a major exporter of nonfat milk products. Though the European Union, New Zealand, and Australia have long been the major players, the U.S. has been the leading exporter since 2005. The U.S. is expected to remain the leader through 2007 with an expected 295,000 metric tons exported, an increase of 1.7% over 2006 levels, even as the overall market is expected to contract slightly. The tight market has led to higher international prices, which in turn have boosted domestic prices.

Federal Milk Marketing Order Program

AMS administers, among other programs, the Federal milk marketing order program. Federal milk marketing orders are authorized by the Agricultural Marketing Agreement Act of 1937, as amended. The Act authorizes the Secretary of Agriculture “to establish and maintain such orderly marketing conditions ...as will provide, in the interests of producers and consumers, an orderly flow of the supply ...to avoid unreasonable fluctuations in supplies and prices.” (7 U.S.C 602)

Milk Marketing Orders are funded through user fees, with AMS Federal oversight provided through mandatory funds. The 10 Federal orders cover a majority of the U.S

and are a major part of milk marketing in the United States. Receipts of producer milk by handlers regulated under Federal milk marketing orders totaled 120.6 billion pounds in 2006. Federal order receipts were about 67 percent of total US milk marketings of 180.8 billion pounds. More than 90 percent of U.S. milk is marketed under either Federal orders or under similar regulations issued by State governments (California alone regulated over 21 percent of U.S. milk marketings in 2006). The number of farmers (producers) delivering milk to handlers regulated by Federal milk marketing orders each month in 2006 averaged 52,725, or about 85 percent of the 61,990 licensed dairy herds (NASS – Milk Production Feb. 2007).

What Federal Orders Do

The Federal milk marketing order system facilitates the marketing of milk by dairy farmers and their cooperative associations. Federal orders regulate handlers who buy milk from farmers and their cooperatives for use in fluid milk products. The Federal order under which a handler is regulated generally depends on where a handler sells fluid milk products. The defined Federal marketing areas are areas in which fluid milk handlers compete with each other for fluid milk sales. With minor exceptions, handlers do not have to be located in a marketing area to be regulated.

Federal orders set minimum prices paid by regulated handlers for milk according to how it is used. Federal order minimum prices for milk in manufacturing uses are based on pricing formulas that reflect the wholesale prices of manufactured dairy products, manufacturing costs, and milk-to-product conversion factors. Minimum fluid (Class I)

milk prices are based on minimum prices for milk in manufacturing uses plus differentials that reflect the additional costs of marketing milk for fluid uses at different locations. Market-generated Class I prices generally exceed Federal order minimum Class I prices, the differences being referred to as over-order premiums. Over-order premiums are regularly generated for milk used in other classes (uses) as well.

Dairy farmers who supply enough milk to a market's fluid handlers to meet an order's performance standards share in the revenue of all milk sales under the order. Regardless of how an individual dairy farmer's milk is used, the farmer receives at least the blend or market average minimum price for milk sold in all classes. Blend prices received by dairy farmers are adjusted to the location of delivery, and thus reflect some of the additional costs of marketing milk for fluid use compared to manufacturing uses. Federal milk orders provide a structured means of sharing the benefits and compensating for the additional costs of supplying the Class I needs of a market and prevent dairy farmers from being subject to undue pressures from buyers in the marketing of a highly perishable product.

Milk marketing orders also benefit dairy farmers, manufacturers and processors and others in the marketing chain in other ways. In addition to the market information made available by Dairy Market News, the Federal milk order program amasses a considerable amount of data on producer numbers, milk marketings, prices, fluid milk sales, and dairy product production that AMS publishes for the use of all market participants. These data are made available over the internet and thus are more current and accessible than ever

before. Much of the data disseminated are audited by employees in our Market Administrator offices.

A milk market administrator administers each order. The duties performed by the market administrator and staff are specified in each order. Each month they compute and publish class and uniform prices as well as other required prices. The staff verifies each handler's reports and that their payments are correct and timely through an audit program.

The market administrator and staff prepare statistics and information concerning operations under the order, keep records and books that clearly reflect the transactions provided for in the order, and disseminate information to the public. The market administrator and staff also receive and investigate any complaints of violations of the order. Market administrator and staff expenses are paid from an administrative fund derived through assessments per hundredweight of milk pooled by regulated handlers. Most of the orders also provide for a marketing service payment per hundredweight which covers the expense of providing market information and for the verification of weights, sampling, and testing of milk received from producers (farmers) who are not members of qualified cooperatives that are performing such services. The cost of these services is borne by producers.

What Federal Orders Don't Do

The Federal milk marketing order program is a marketing program. Although the marketing order program is not a price or income support program, each of the orders establishes minimum prices, based upon supply and demand in the market place, paid by regulated handlers for milk according to how it is used. USDA operates the Milk Price Support Program and the Milk Income Loss Contract (MILC) Program for price and income support purposes.

Federal milk orders do not regulate dairy farmers. Marketing orders regulate the activities of milk handlers. Dairy farmers are able to produce as much milk as they wish and they can sell to any handler who is willing to buy their milk.

Federal orders do not guarantee a market for a farmer's milk. Farmers must find their own market and must arrange for the delivery of their milk to the handlers and bear those marketing costs.

Federal Milk Marketing Orders Remain an Important Tool for Dairy Farmers

First authorized in 1937, milk marketing orders today remain an important tool for dairy farmers. Although the market has changed since that time, many of the marketing conditions that precipitated the passage of the Act exist today. While dairy farmers and their cooperatives continue to grow in size and have integrated forward into dairy product manufacturing, the fluid milk processing industry continues to become more

concentrated. The ratio of dairy farmers to fluid milk processors continues to remain high today.

Further up the marketing chain, the grocery industry is also highly concentrated. Absent milk marketing orders, the potential exists to push lower milk prices down to handlers who in turn could push lower prices down to dairy farmers to below sustainable long-run average cost levels. The perishable nature of the raw farm milk sets up a condition of farmer (producer) vulnerability to handler market, which unlike storable commodities cannot be withheld from the market in an effort to gain a better price; Federal milk orders help balance the competition between the many dairy farmers (sellers) and the relatively few fluid milk processors (buyers).

Federal Order Rulemaking Process

The Federal order rulemaking process has received significant attention recently by all sectors of the industry regarding the length of time involved to accomplish regulatory changes.

The Agricultural Marketing Agreement Act of 1937, as amended, requires that formal rulemaking procedures be used to make changes to a Federal milk marketing order. The process is extensive and time consuming, but provides for *maximum industry participation and transparency*. The industry offers proposals, provides testimony in support of or in opposition to proposals and may cross-examine witnesses at public hearings before an Administrative Law Judge, submits briefs and proposed findings of

facts, comments on recommended decisions, and producers approve final decisions through referendums before any changes to an order are effective.

AMS is aware of the concern about timely decisions and in response undertook an extensive internal review of its part of the process and developed several new rulemaking initiatives and customer service standards. During this process, AMS consulted with other organizations, including the California Department of Agriculture, to determine best practices that could be incorporated into the Federal rulemaking process. Our goal was to improve timeliness while maintaining transparency and the opportunity for public involvement that currently exists. Some of the steps initiated by AMS include:

- Having meetings to discuss issues with interested parties before proposals are submitted.
- Holding pre-hearing information sessions to discuss proposals received with interested parties before *ex parte* rulemaking restrictions apply.
- Developing supplemental rules of practice to better define public input timelines once the formal rulemaking process begins.
- Procuring the services of court reporters in terms of “best value” rather than lowest cost to reduce transcript delivery times and improve their quality and accuracy.

Under the new customer service standards, we are planning to have amendments issued within 14 months for any non-emergency rulemaking proceeding. This process would allow three months in total for public participation. In situations when emergency marketing conditions warrant the omission of a recommended decision, the Department could move from a hearing to final amendments in 10 months or less. These new

standards are reducing the amendatory time from more than two years to around one year.

We have had extensive discussions with the industry regarding the time frames necessary for ensuring sound, reasonable decisions that allow maximum public participation and have concluded that our revised process will yield better results than a mandated time frame. Under a mandated time frame, all decisions are allowed equivalent time even though the rulemaking proceedings may differ significantly in complexity, scope, and the number of interested parties involved (e.g., proceedings involving more than one order, addressing a significant national issue, or that are highly controversial).

In addition, urgent issues that arise, which are extremely important to maintaining orderly marketing conditions would be placed in line with ongoing proceedings. This would not be beneficial to the industry.

One example of such a situation involved changes to the Southeastern orders as a result of the hurricanes. Disorderly marketing conditions were developing as a result of the devastation in the region. Therefore, working together with industry, USDA held a hearing on October 7, 2004, allowed public participation and briefing, held a producer vote, and implemented changes on December 10—a mere two months after the hearing. While this was an unusual situation, I believe it is important to emphasize that when the industry is unified in their position and disorderly marketing occurs, things can happen quickly while still allowing important public participation.

Of course, situations like this result in other decisions being delayed because of limited resources. The decisions being delayed are typically those that are not of an urgent nature to the industry or that have been implemented on an interim basis. If mandated time frames were implemented, USDA would no longer have discretion to expedite certain issues that are of utmost importance to the industry.

Another key concern that we have with mandated time frames is with regard to litigation. Decisions issued by USDA must withstand scrutiny in the legal system. This appears to be increasingly important as more decisions are challenged when a party fails to prevail on an issue. If mandated time frames were implemented, highly controversial decisions may not be as sound, reasonable and complete as they are today, potentially resulting in further litigation. Ultimately, this may result in further delays in implementing changes - a potential consequence of the mandated time frames. It is vitally important that we have time to develop the best, sound, and reasonable decisions possible based upon the record evidence to withstand such challenges. Nonetheless, as already noted, AMS is committed to improving the process.

Changing Market Conditions

Again, while some of the marketing conditions that existed when milk marketing orders were first authorized still exist today, other marketing conditions have changed and Congress, the industry, and the Administration have worked to keep the program attuned to the marketing conditions of today. Since the authorizing legislation was passed in

1937, the Act has been amended numerous times to add additional authorities when needed. Authorities in the Act that were no longer needed or were no longer considered economically efficient were removed or allowed to expire. One example of this is the authority for Class I base plans that was allowed to expire in the early 1970s.

The Federal milk marketing order program has continually changed to reflect relevant marketing conditions facing the dairy industry. Since 2000, AMS has undertaken 19 rulemakings to amend Federal orders involving more than 62 publications in the Federal Register. Of these rulemakings, 14 have been finalized. Major changes have included:

- Consolidating and expansion of milk marketing areas as handler competitive areas increased in geographic scope
- Adopting of a uniform classification of products as they began to move more easily around the country
- Tying all milk prices to manufactured product wholesale prices when the competitive pay price series was becoming suspect as an indicator of the value of milk
- Altering the pricing of nonfat dry milk used in the production of reconstituted milk to reflect the expanded sourcing of such product
- And, adopting a national Class I pricing surface to stabilize plant pricing as marketing conditions changed to cause plants to shift among areas of regulation.

Finally, I would like to again stress that Federal milk marketing orders today remain an important tool for dairy farmers. They are not a price support program or an income support program. AMS will continue to work with all sectors of the U.S. dairy industry

to administer Federal milk marketing orders so that dairy farmers are assured of a reasonable minimum price for their milk, and consumers are assured an adequate supply of fluid milk to meet their needs throughout the year.

This concludes my statement, Mr. Chairman. I would be pleased to respond to questions.