United States Department of Agriculture

Agricultural Marketing Service

Federal Milk Order Hearing

December 11, 2006

7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126 and 1131

{Docket No. AO-14-A76, et al.; DA-07-01}

I am Neil Gulden, Director of Fluid Marketing for Associated Milk Producers Inc. (AMPI). My office address is 315 North Broadway, New Ulm, Minnesota, 56073. I have been employed by AMPI for 36 years, the last 30 of which I have represented AMPI at most federal order hearing procedures.

AMPI represents approximately 4000 dairy farmers in 7 midwest states. Currently our milk is pooled in Federal Orders 1030 (Upper Midwest) and 1032 (Central).

My testimony is in opposition to proposals 1, 2, 3, 4 and 5 as offered by National Milk Producers Federation (NMPF).

AMPI is a member of National Milk Producers Federation, but certainly are not represented by NMPF on this issue.

In their request for an emergency hearing on Class I and II prices, NMPF states their basis is directly related to the proceedings in [Docket No. AO-14-A74, et al.; DA-06-01] dealing with "make allowance" adjustments in the formulas for setting Class III and IV prices. They state that "any changes to the Class III and IV make allowances will also result in lower Class I and II prices for producers" and that this will create unnecessary and unjustified economic hardships for dairy producers.

The fact is that formula pricing with fixed make allowances has gradually overstated Class III and IV prices relative to the value of the commodities used in those formulas, namely cheese, whey powder, butter and nonfat dry milk. To the extent that processing costs have increased since the late 1990's when the make allowances were determined, manufacturers of these products have not been able to realize the "formula calculated" Class III and IV return from the market value of these commodities. On the other hand, since Class I and II prices are a direct result of Class III and IV prices plus a differential, suppliers of Class I and II milk simply pass on these "formula calculated" minimum prices to fluid milk customers, who are legally bound to pay them.

NMPF argues that if these make allowances are increased to actual or increased at all, that suppliers of Class I and II milk should receive "offsetting compensation".

In the absence of component formula pricing the make allowances would not have even been an issue because the competitive price used prior would have reflected the increased make allowances in the Class III and IV price and consequently in the Class I and II prices.

We believe that what has really been created by formula pricing without make allowance adjustments, is an unintended increase of Class I and II milk prices and enhanced blend prices, the benefit of which was disproportionately based on utilization. NMPF's proposal now treats this price enhancement as an entitlement.

The fact, as NMPF states, that producers costs of milk production and supplying Class I and II markets has increased is indisputable. However, this is insufficient reason to effectively raise Class I and II differentials at all locations, as stated in the Departments preliminary economic analysis of the NMPF proposal.

One of the key questions is whether there is an adequate supply of grade "A" milk. USDA's Agricultural Marketing Service's Milk Marketing Order Statistics for January through October 2006 for all markets combined shows a Class I utilization of 37%. The balance, almost 2/3 of the federal order milk has to be used in some form of manufacturing either Class II, III or IV. We contend that the federal order pricing system has created more than a sufficient supply for Class I use.

The Federal Milk Marketing Order program is a marketing program with the objective of assuring that fluid (drinking) milk markets are adequately supplied. There is no guarantee that all the milk needed will be produced or bottled in those same markets, but the fact that the system, by setting minimum prices, has created enough grade A milk to get the job done, is hard to deny.

Logistics may be more of a problem in some areas than others, but the system and the market place have taken care of that through individual order regulations, plus over-order premium structures where needed. If there isn't enough milk year-round in some areas, the market finds the best way to get it there and should be allowed to continue to do so. There are better regulatory tools, with much less burden on producers and consumers, for this purpose. These include expanded use of transportation credits, balancing payments, and location adjustments in producer blend prices to account for differences in raw milk value to the market in which milk is pooled.

The issue as we see it is not whether cost of production and supplying Class I and II milk have increased. The issue is whether the system has created the proper incentive to provide enough Grade A milk and if the markets are being adequately supplied. The answer to both of those is yes.

Effectively increasing Class I differentials 73¢ per hundredweight across all orders would certainly raise prices to dairy farmers, but very inequitably. A lot more to some in higher Class I utilization markets and very little to those in predominantly manufacturing areas of the country.

It would most certainly create a supply response which would work its way back into manufactured products and have a depressing price effect on Class III and IV prices. This would effectively turn the limited Class I benefit in a low utilization market into a net negative result.

Keeping Class I and II prices linked directly to commodity markets through the Class III and IV prices is important. Supply and demand does work and as long as the Federal Milk Marketing Order objectives, as we have discussed, are being met, effectively increasing Class I and II differentials would simply help some farmers at the expense of others. The Federal Milk Marketing Order program is a marketing tool, not a support price program.

If USDA truly wants to help cover dairy farmer's increased costs, one equitable way to handle any effective increase in Class I and II differentials would be to pool the revenue generated on a National basis.

Another alternative would be to make the price support program better reflect actual costs. I realize this is outside the ability of this proceeding, but as long as the link to Class III and IV is retained, it absolutely helps all dairy farmers.

Emergency Marketing Conditions

We believe that emergency marketing conditions do not exist, especially in light of the short time frame between the hearing announcement and the hearing date. A recommended decision with ample time for comments is needed before any action by USDA. Particularly in light of the possible ramifications and regional contentiousness of this issue.

This concludes my statement.