

May 22, 2007

Remarks by Tom Thompson, President
Georgia Milk Producers, Inc.
USDA Federal Orders 5-6-7 Emergency Hearing
Tampa, Florida

Thank you for the opportunity to appear before you to discuss a subject vital to all of Georgia's dairy farm families. I am Tom Thompson, President of Georgia Milk Producers, as well as a dairyman from Eatonton, Georgia. Georgia Milk Producers represents all Georgia dairymen and speaks on their behalf in matters such as we are here to address today. It is in this role that I also represent all Georgia dairymen on the S E Steering Committee, joining other members of this Committee speaking at this hearing.

We applaud USDA for holding this emergency hearing to address matters of grave concern to those of us trying to produce milk in the Southeast. We support the proposals made by DCMA at this hearing as a first step in addressing the Federal Order rules and regulations that appear to be at the heart of the economic plight of the SE milk producer.

The Southeast is a unique region. On one hand, it contains one of the fastest increasing populations in the US. On the other hand, its milk production is decreasing at one of the highest rates in the country, and is now deficit year round. Georgia alone imports more than 1,000 tanker loads per month. We need to attempt to understand this seeming paradox.

The Southeast has the highest cost of production in the US. Contributing to this cost is high heat and humidity, causing wide swings in cool/hot weather milk production. Since production cost is high, the Southeast is not able to produce milk intended for manufacturing purposes, instead trying to operate in a niche market supplying milk primarily for the needs of local bottling plants.

Another factor contributing to our high production cost is a lack of proximity to abundant grain and forage production. We have neither the vast rich soils of the corn belt nor the federally subsidized irrigation of the West. In the Piedmont region of Georgia where our dairy is located, there is no aquifer to supply water so desperately needed to grow the forage crops that are currently being decimated by the second year of drought.

Let's look a little closer at the region's declining milk production. Since Federal Order boundaries do not exactly follow state lines, we will use USDA's production figures for Georgia, Alabama, Mississippi, and Tennessee for annual milk production trends from 2000 through 2006. These states have experienced a 3.6% annual decline in milk production between 2000 and 2006: beginning in 2000 with 3 billion, 727 million lbs and falling to 2 billion, 997 million lbs in 2006. These numbers have been translated into trend lines by the Market Administrator's office in Atlanta and would indicate that virtually no dairies will exist in the Southeast in 10 years.

One of the proposals that is part of the DCMA package we support here today addresses the out-of-date differentials that are supposed to reflect the cost of moving milk from areas of plentiful supply to deficit areas. The differentials in place today were done in an era of gas in the \$1/gallon range, when stainless steel over the road tankers and the tractors that pull them were far cheaper, and truck drivers pay was less than ½ of what is paid today. Adjusting differentials to reflect changes in transportation costs is long overdue. We strongly support this much-needed change.

Can the Southeast dairymen be economically viable in supplying the needs of the SE's primarily fluid milk plants, whose outputs are typically 90% Class I? I would suggest that the answer is: "it all depends". In my economics courses at Emory University's School of Business we learned that the price of a commodity in a deficit area was the f.o.b. price of this commodity in a plentiful area plus the true cost of freight to the deficit area. There was no concept that the producer in the deficit area should have his price reduced by the cost to deliver additional amounts from a distant area, whether this cost occurred through "pooling", "transportation credits", "reblending", or some other means.

In order to put this in perspective let's review a little history. In the late 1960's, Georgia's Milk Commission was ruled unconstitutional, and Georgia subsequently got its own Georgia Federal Order. Unlike today where the co ops controlling the majority of milk in the Southeast have their majority membership living outside the Southeast, Co-ops in Georgia were local, represented Georgia dairymen, and the Georgia Federal Order served the industry well. Class I utilization was normally in the high 80's and low to mid-90's. Subsequent years added a state here and a state there to the Order that soon became the Southeast Order. Each geographical increase in the Order resulted in small declines in Class I utilization. However, USDA's January 2000 inclusion of southern Missouri and an additional portion of Arkansas resulted in no small decline: this time the Southeast saw a drop of 15-20 points in utilization. Instead of utilization that typically ranged from the 80's to 90's, we now saw utilization hovering in the 50's to 60's with its corresponding transfer of milk revenues from those dairymen serving the needs of bottling plants in their close proximity every day, to those far distant who were "qualified" by "touch base" and "diversion" rules. Since January 2000 my partners and I estimate this change in utilization has cost our 800 cow dairy hundreds of thousands of dollars. We cannot continue to operate our dairy under these adverse economic conditions. Therefore, we and other Georgia milk producers applaud and support DCMA's proposal to place a cap on "diversions" as a first needed step to raise utilizations. Since this is an "emergency hearing", USDA has not had the time to do a study to determine how much "stand-by" capacity is required to supply the Southeast's deficit needs. We suggest that USDA should conduct this analysis and initiate subsequent changes that their study might deem warranted in order to more closely approximate the "real economics" I was taught years ago.

It is my belief the purpose of this hearing is an attempt to address the economic issues that are forcing Southeast dairymen out of business, with the SE becoming increasingly dependent on milk transported many times more than 1,000 miles from where it is

produced to where it is needed. This has vast implications of increasing demands on foreign oil, air pollution, congested highways, vulnerability to bio-terrorism, in addition to the insidious economic bleeding of the Southeast milk producer.

" According to DCMA's estimates, "The combined impact of additional Class I pooled revenue and lower diversion limits would increase Federal Order minimum blend prices. Based on 2006 annual data the estimated increase in blend prices at the various Order Base zones are: Approximately .75 hundredweight in F.O.7 (Atlanta/Dacula)" (Reference "Proposed Federal Orders 5, 6, & 7 Amendments—Talking Points" by DCMA.) Other locations and orders vary from these numbers.

I would like to reference "Projected Increases in Milk Production Resulting from Proposed Price Changes" compiled by Dr. Tommie Shepherd, University of GA, and Dr. Geoff Benson, North Carolina State University. (note: to be read and attached as part of testimony).

Given the limited impact on current milk production trends that this analysis indicates would be expected from DCMA's proposal, this underscores our position that although we fully support DCMA's proposal to address the SE's economic plight, it is but a first step to correct the economic inequities that have plagued the SE's ability to continue local milk production. It is my belief that USDA first needs to implement DCMA's proposal and then use the data and qualified economists at its disposal, becoming pro-active similar to the Federal Reserve Board, as opposed to reactive. After implementation of the DCMA proposal, USDA should also monitor the results. If the goal is to achieve a reversal of the present trends in the Southeast, USDA needs to give serious thought to a partial decoupling of Class I pricing from manufacturing milk prices set primarily by Western over production, production that controls our fluid milk price but which is physically unrelated to our market. The need for this review is underscored by the current lack of confidence in the veracity of the pricing data provided. Price volatility may be acceptable and understandable in manufacturing prices; volatility in fluid pricing typically robs both the consumer and the dairyman. Georgia and other Southeast dairymen are tired of being robbed.

Given the dismal track history of "reform" inflicted on the SE since 2000, nothing less than a review and readdress by USDA is needed to achieve "true economics". Only then will there be a chance to stop the "cannibalization" of the Southeast.

Projected Increases in Milk Production Resulting from Proposed Price Changes

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Farm Milk Supply Elasticities

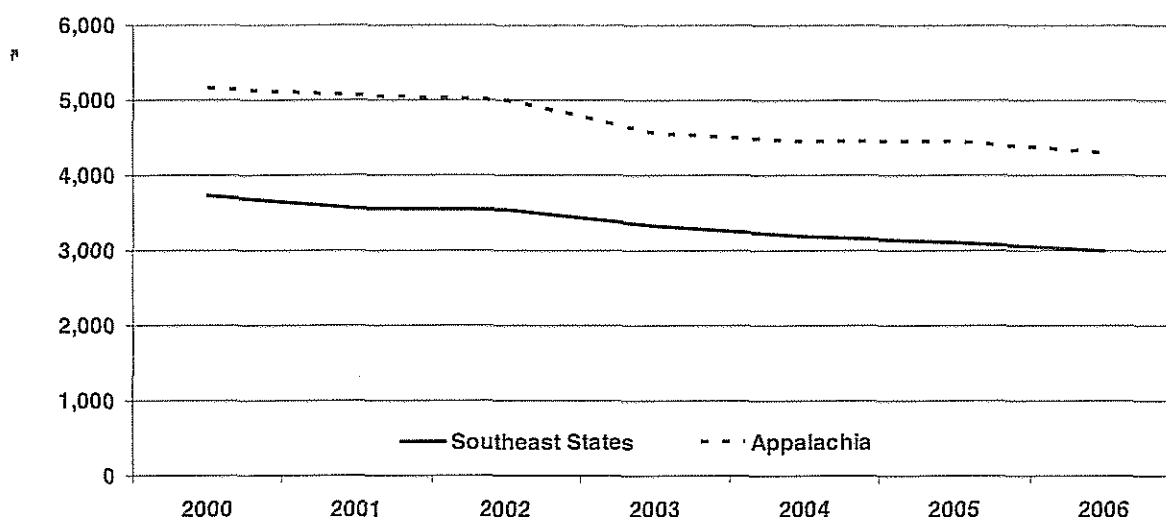
The primary reason cited for the proposed changes to the Southeast, Appalachian, Florida Federal Milk Marketing Orders is concern over declining milk production levels in these areas. To assess the impact of DCMA's proposed Class I differential increases and Diversion Limit decreases on milk production in the Southeast and Appalachia, it is beneficial to understand how changes in farm level milk prices impact production. In addition to the price of milk, numerous other factors may influence production including feed prices, land values, replacement heifer prices, and government programs, to name a few. Extensive research has been conducted in the area of farm level milk production responses to changes in milk prices at a national level, yielding a wide range of estimated price elasticities. Price elasticity is a measure of the expected percentage change in the quantity of a commodity produced given a one percent change in its price. A review of current, peer reviewed, academic research reveals estimates ranging from .07 to .59. This includes estimates from sources including the United States Office of Management and Budget (OMB), the Food and Agriculture Policy Research Institute (FAPRI), as well as other authors listed in references at the end of this paper. Little, if any work has been published in the area of estimating supply response functions for the southeast and even less specifically related to individual states.

Milk Production Trends in the Southeast and Appalachia

Figure 1 shows annual milk production for selected states for 2000 – 2006. Since Federal Order boundaries do not exactly follow state lines, the states of Georgia, Alabama, Mississippi, and Tennessee are referred to as the "southeast" and North Carolina, South Carolina, Virginia, and Kentucky are referred to as Appalachia.

Based on data from the National Agricultural Statistics Service (NASS), milk production in the southeast states has declined by an average of 122 million pounds, or 3.6 % annually since 2000. Similarly, milk production in the Appalachian states has declined by an average of 143 million pounds or 3.0 % annually since 2000.

Figure 1.



Estimated Milk Supply Response

A widely circulated set of "Talking Points" compiled by proponents of the proposal states that "the combined impact of additional Class I pooled revenue and lowered diversion limits would increase Federal Order minimum blend prices. Based on 2006 annual data the estimated increase in blend prices at the various Order base zones are: Approximately \$0.28 per hundredweight in F.O. 5 (Charlotte/Winston Salem) and Approximately \$0.75 per hundredweight in F.O. 7 (Atlanta/Dacula). Blend price increases in other cities would vary up or down from the above values based on each city's proposed increase in Class I prices."

Combining these estimated price increases with the afore mentioned estimated milk price (supply) elasticities offers a projection of how much milk production in the Southeast and Appalachia may be expected to increase as a result of the proposed Federal Order changes. A range of milk supply increases is derived based on the low and high elasticity estimates cited above. The low estimate (.07) is attributed to FAPRI and we consider it a short-term or partial response. The high estimate (.59) is attributed to Suzuki and Kaiser and we consider it a long-term or full effect. Dairy farmers have limited options to respond to price increases in the short run. Milking cow numbers cannot be adjusted easily except by less rigorous culling. Options to boost milk production per cow are similarly limited in a well managed herd. In the longer term, some additional heifers can be raised and the rate of dairy farm exits may slow, slowing or reversing the long term trend in cow numbers.

Between 2000 and 2006, the average mailbox milk price, the price actually received by farmers for their milk, as published by USDA was \$14.72 per hundredweight for the Southeast Federal Milk Marketing Order and \$14.27 for the Appalachian Order. The proponents estimate of a \$0.75 per hundredweight increase represents a 5% increase in the average Southeast Federal Order Uniform

price. The estimated \$0.28 per hundredweight increase represents a 2% increase in the Appalachian Federal Order Uniform price. The results of applying these estimated price increases to the indicated supply elasticities are shown in Figure 2.

Figure 2. Estimated Annual Percentage Increase In Milk Production

	Low Elasticity (.07) = Short term or partial effect	High Elasticity (.59) = Long term or full effect
Southeast Increase \$0.75	.35% Increase in Production	2.95% Increase in Production
Appalachian Increase \$0.28	.14% Increase in Production	1.18% Increase in Production

Table 2 demonstrates that, ^{given} the estimated price increases and supply response elasticities, production in the southeast can generally be expected to increase by less than 3% and production in Appalachia can generally be expected to increase by less than 1.2%. These are lower than the average annual rates of decline of 3.6% and 3.0% experienced since 2000 by the southeast and Appalachian states, respectively. Applying these estimated percentage increases to 2006 production levels in the two regions yields the expected milk production increases shown in Figure 3.

Figure 3. Estimated Annual Increase In Milk Production

	Low Elasticity (.07) = Short term or partial effect	High Elasticity (.59) = Long term or full effect
Southeast Increase \$0.75	10,489,000 lbs.	88,411,500 lbs.
Appalachian Increase \$0.28	6,011,600 lbs.	50,669,200 lbs.

Based on these estimates, the expected increase in milk production in the two areas as a result of the anticipated price increase is less than the current average annual rate of decline, suggesting that these modest price increases will have a very limited impact on current milk production trends.

References

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Table 4.2 Own Price Elasticities from U.S. Dairy Industry Models

	Heien & Wessells (1988)	Huang (1993)	Suzuki & Kaiser (1997)	Cox et al.	FAPRI	OMB	Dairy Compact Model
Farm Supply			0.59 ¹	0.56 ²	0.07 to 0.20 ³	0.10 ³	0.35 ²
Milk used for:							
Fluid			-0.16			-0.08	
Manufacturing:			-0.22			-0.25	
Soft products				-0.42	-0.11		-0.25
Cheese					-0.88		0.20 ⁵
Butter/nonfat					-1.62		
Retail Demand:							
Fluid	-0.63	-0.74		-0.14	-0.10 to -0.23		-0.32
Cheese	-0.52	-0.25		-0.16 ⁴	-0.37		-0.35
Butter	-0.73	-0.24		-0.09	-0.25		-0.50
Nonfat dry milk				-0.45	-0.58		-0.60
Ice cream		0.08		-0.33			

Note: FAPRI = Food and Agricultural Policy Research Institute; OMB = Office of Management and Budget. See the bibliography for references.

¹ Long-run elasticity.

² Intermediate-run elasticity.

³ Short-run elasticity.

⁴ American cheese.

⁵ This is not a price elasticity. It applies to the proportion of excess milk used for Class 3 use. See the model specification.

The elasticities used in this dairy compact study are listed in Table 4.2. A milk supply elasticity of 0.35 was used to reflect an intermediate-run response to the farm price of milk. This number was higher than FAPRI and OMB's short-run elasticity, but lower than Suzuki and Kaiser's long-run estimate.

Mill 164

Southeast States ←

Appalachia

2000 → 3,727			5,154		
3,565	162	0.043467	5,066	88	0.017074
3,540	25	0.007013	5,006	60	0.011844
3,324	216	0.061017	4,558	448	0.089493
3,195	129	0.038809	4,446	112	0.024572
3,106	89	0.027856	4,451	-5	-0.001125
2000 → 2,997	109	0.035093	4,294	157	0.035273
	122	0.036		143	0.030

10,489,500
88,411,500

6,011,600
50,669,200

	AL	GA	FL	MS	NC	SC	VA	TN
2000	348	1,433	2,463	541	1,189	370	1,900	1,405
2001	300	1,433	2,411	497	1,154	367	1,885	1,335
2002	277	1,470	2,308	478	1,137	364	1,891	1,315
2003	252	1,444	2,161	423	1,044	318	1,731	1,205
2004	245	1,416	2,253	379	1,006	287	1,731	1,155
2005	224	1,398	2,273	382	1,012	288	1,784	1,102
2006	203	1,404	2,167	341	944	278	1,771	1,049