

Testimony
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Good Morning Chairman Brubaker, Chairman O'Pake and distinguished Members of the Senate Agriculture & Rural Affairs Committee. Thank you for this important opportunity to discuss the challenges facing the dairy industry and the work being done to support Pennsylvania producers. It is an honor to be here today on behalf of Governor Rendell, who, as you know, has been a tremendous advocate for Pennsylvania's dairy farmers.

In December of 2009, this Committee hosted a public conversation about what I have termed a crisis in price and a crisis in confidence for the dairy industry. The hearing last year brought together a cross-section of individuals and organizations impacted by historically low prices. At that time, the witnesses looked at potential actions we could take here in Pennsylvania to not just provide immediate relief to struggling producers, but to use this crisis to effect long-term changes that will positively benefit the largest sector of Pennsylvania agriculture. This testimony included details on what have become known as "stranded premiums," or funds paid by consumers at the retail level that have not made their way to the farm gate.

This morning we have an opportunity to share with you an update on actions taken to date and additional steps that can be taken here at the state level to bolster our dairy industry.

For the past four years, the Rendell Administration has worked to take advantage of the full authority of Pennsylvania's milk marketing law by encouraging action by the Pennsylvania Milk Marketing Board to be more responsive to changes in market conditions and industry practices. Beginning in 2006, the Governor and the Department filed two petitions with the Board, 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 percent of all Pennsylvania-produced fluid milk, despite the fact that approximately 40-45 percent of all Pennsylvania-produced milk is sold as fluid milk. The quantity of milk representing the difference between those two numbers (between 20 – 30 percent of all Pennsylvania-produced milk) loses qualification for the Board's over-order premium because it doesn't meet the PMMB's current three-part test of "produced, processed and sold in PA."

As 2009 progressed and the dairy crisis deepened, Governor Rendell again reached out to the Board on September 15, 2009, requesting an analysis and set of recommendations on 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 Board responded with a detailed narrative of the features and perceived limitations of its present pricing structure and a list of items for consideration. This response, the Governor's follow-up communication on November 13, 2009, several meetings, and a final set of recommendations from the Board dated December 23, 2009, has focused the attention of the Governor's office and the Department on two fronts.

The first area of focus is to analyze and assess all options to improve the administration of the current over-order premium to include milk and dairy producers

that, for one reason or another, do not qualify for the PMMB's over-order premium as currently administered. The over-order premium's requirement that the milk be "produced, processed and sold in PA" and be utilized as Class 1 fluid drinking milk leads to a large quantity of milk and many dairy farmers being excluded. The reasons for this have to be better articulated in order to foster a productive dialogue on how to address it.

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 percent of all PA-produced milk utilized as fluid milk but not receiving the PMMB's over-order premium. The status of those producing milk that is not sold as Class 1 fluid milk must also be accounted for and addressed.

Significant changes benefitting Pennsylvania's dairy producers will not be possible without addressing these issues. The solutions are multi-faceted and may include changes to statutes, regulations and to standing orders of the PMMB. We welcome today's opportunity to provide a roadmap to better understand these broad issues.

The second more-targeted focus is currently on a gap in the over-order premium's administration which results in diminished or no returns of the over-order premium to PA dairy producers. This gap exists as a result of the method of establishing the minimum wholesale price, paid by retailers, 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 to the dairy producer in its procurement. 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 percent. When the over-order premium is not paid in the procurement, that margin becomes skewed and the portion of the retail price paid by consumers and intended by the PMMB to go to the dairy producer does not in fact make its way back to the farm. This is the so-called "stranded premium."

The PMMB identified three action items that, if completed, would increase the money being returned to dairy producers in Pennsylvania and work to eliminate the stranded premium problem.

The first and most immediate action identified was to change the over-order premium obligation calculation when a milk dealer procures both in-state and out-of-state milk. This led to a petition filed jointly by PMMB staff, the Governor and the Department on December 30, 2009 and decided by the Board on June 2, 2010.

The other two action items were statutory changes to the Milk Marketing Law in order to enable to PMMB to assess the over-order premium on two subsets of milk it currently does not cover: (1) milk produced by a PA dairy farmer which leaves the state for processing but re-enters and is sold at retail; and (2) milk produced and processed in PA which leaves the state through a wholesale transaction but re-enters for retail sale. In both instances the milk is sold in PA subject to PA's minimum retail price, including the \$.25 per gallon over-order premium, yet the over-order premium is not passed back to the PA dairy producer.

The Milk Marketing Law must be first amended to track and capture such milk for the purpose of passing on the over-order premium.

Thanks in part to the collective efforts of PDA and PMMB staff, the Board recently voted unanimously to grant the petition filed and change its method of calculating the over-order premium payment obligation when a milk dealer procures both in-state and out-of-state milk. The PMMB's June 2 decision translates into approximately \$6.7 million more annually paid to PA's milk producers, based on the current level of over-order premium. Under the Milk Marketing Board's ruling, a milk processor who purchases milk from both Pennsylvania and out-of-state dairy farmers will be required to pay the entire over-order premium on the Pennsylvania-procured milk. Under the existing calculation, the amount paid to producers is reduced by the ratio of milk purchased from Pennsylvania producers to total milk purchases. For example, if half of a processor's milk is purchased from Pennsylvania, the over-order premium obligation to those producers is reduced by half. In other words, only \$.12 ½ cents of the over-order premium amount in the retail price paid by PA consumers reaches its intended destination. Under the new calculation, 100% of the over-order premium received by a milk processor in the minimum wholesale price would be passed on to the dairy producer.

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

Before we can move further forward, we need to better understand and have a common discourse on three particular variables in the administration of the over-order premium.

WHAT milk is covered?

First, we need to examine what milk is covered by the over-order premium and the options and variables for making sure that more of that \$.25 per gallon makes its way back to the dairy producer. This takes an understanding of the gaps in the "produced, processed and sold in PA" requirement and the gaps that create the stranded premium.

WHERE is the over-order premium obligation assessed and collected?

Secondly, we need to examine and understand the options regarding how and where the over-order premium obligation is assessed and collected, so as to be returned to the Pennsylvania dairy farmer.

WHO receives distribution of the over-order premium?

Finally, we need to examine and understand the options for distribution of the over-order premium once the obligation is assessed and collected. This inquiry raises the question of "to whom should the premium dollars be paid?" once they are generated by PA consumers purchasing fluid milk. Should they be paid to only the producers whose milk was utilized as fluid milk or to a broader group of dairy producers?

In such an inquiry, we must not overlook the benefit conferred on PA's dairy producers by the relatively high percentage of their milk devoted to the more lucrative Class I fluid market. This could not be sustained without the ample availability of outlets for Classes II, III and IV. Those outlets are currently supplied

in large part by the efforts and operations of the milk producer cooperatives operating in the Commonwealth. Without those outlets, we would not have the dairy industry we enjoy in Pennsylvania today. I think it is important to recognize the cooperatives and the balancing they provide by finding a home for over 50% of the milk produced in the Commonwealth, i.e. that milk which is not utilized as Class I.

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. Your Committee and the General Assembly could provide further relief to dairy farmers by acting on the remaining recommendations the Milk Marketing Board outlined to improve the financial stability of Pennsylvania's dairy farms. Thank you for your time and I look forward to the continued opportunity to work with you to find solutions to make the PA dairy industry stronger. Thank you.