

Approved: 2-17-93
Date

MINUTES OF THE SENATE COMMITTEE ON AGRICULTURE

The meeting was called to order by Chairperson David Corbin at 10:00 a.m. on February 16, 1993 in Room 423-S of the Capitol.

All members were present except: Quorum was present

Committee staff present: Raney Gilliland, Legislative Research Department
Jill Wolters, Revisor of Statutes
Lila McClaflin, Committee Secretary

Conferees appearing before the committee:
Mark Reinhardt, Mid-America Dairymen, Inc.
James W. Erickson, Anderson Erickson Dairy Co.

Others attending: See attached list

Not available

The Chairman opened the hearing on SB 72 - creating the dairy marketing advisory board; relating to the powers, duties and functions.

Mark Reinhardt explained the concept of marketing orders and why they thought the legislation was necessary (Attachment 1).

The Chair stated Mr. Erickson from Des Moines, Ia. had asked that he be heard today, so that he would not have to attend on Thursday.

Mr. Erickson requested that any further action on SB 72 be delayed until after March 9, 1993 (Attachment 2).

Due to time restrictions the hearing was continued until February 18.

The next meeting is scheduled for February 17, 1993. SB 247 will be heard at that time. The meeting adjourned at 10:55 a.m.



MID-AMERICA DAIRYMEN, INC.

KANSAS CITY DIVISION

• P.O. BOX 901546

• KANSAS CITY, MISSOURI 64190-1546

• AREA CODE 816-891-7424

Testimony
presented to the
Kansas Senate Committee on
Agriculture
Informational Hearings
on
Kansas State Milk Marketing Act
February 16, 1993
by
Mark Reinhardt

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attachment 1
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Mr. Chairman, members of the committee, I am Mark Reinhardt, manager of the Kansas City Division of Mid-America Dairymen. We are a regional member owned milk marketing cooperative operating in 15 states, predominately in the Midwest, and through contractual arrangements, manage other coops in California and the Southeast U.S. Though operating across the country, our roots are deep in Kansas, as several predecessor cooperatives that originally formed Mid-America Dairymen came from this state. We market the milk from over 9,000 member dairy farmers, approximately 700 of whom live in Kansas. We operate or own interest in three major processing plants in the state and supply milk to five more. We also operate three receiving stations in the state.

I am here today to explain the concept of marketing orders and why it is important for Kansas to implement this enabling legislation.

In recent years, there has been a noticeable and alarming decline in the number of dairy farmers in Kansas. Instability in milk prices to dairy farmers have contributed to their decline.

We support this enabling legislation that creates the Kansas Dairy Marketing Advisory Board, representing dairy producers, handlers (milk processors), consumers, and the State Board of Agriculture. They would be responsible for the issuance and amendment of any proposed Kansas State Milk Marketing Order.

Milk is unique in several ways. It is highly perishable, and as such, must be shipped to market within 2 days. Milk is produced every day, so it must be marketed 365 days a year. Because it cannot be stored at the farm to await higher prices, dairy farmers must be assured fair value for their milk, in order for them to stay in production. Dairy farming requires a large capital base at the farm, limiting a quick entry into production. Milk is also unique in the fact that it has an inelastic demand curve, meaning that consumers will demand about the same amount, despite price variations.

The purpose of a milk marketing order is to insure consumers an adequate and constant supply of pure and wholesome dairy products. This is achieved by assuring dairy farmers fair treatment in the market place.

The only way to insure consumers of a constantly adequate supply is to always have a little more than enough. In an unregulated market, that "little more than enough" milk sets the price for all, driving prices down unrealistically low, which in turn drives dairy farmers out production, which decreases supply,

leaving supplies short of consumer demand, driving prices unrealistically high.

For the past 50 years, Federal Milk Marketing Orders have provided stability in the market place by assuring producers of milk that they will share equitably in the value of their milk. This is done through classified pricing and pooling of proceeds to pay dairymen a blend price for their milk. Classified pricing recognizes that different uses of milk provide different values for the milk used to produce them. Class III products (butter, nonfat dry milk powder, and cheese) have their value set on the open market through commodity trading. These commodity prices directly affect the prices the plants that produce these products can pay farmers. Minnesota and Wisconsin manufacturing grade farm pay prices are used to calculate the M-W which is used as the Class III price in calculating Grade A blend prices. The M-W is used because it represents the price of the lowest value products in the market and is arrived at competitively. Cottage cheese, ice cream and other "soft products" are classified as Class II. They are recognized as having a somewhat higher value, so the milk going into their production returns a somewhat higher value. Class I products (fluid milk) are recognized as having the highest value. Pooling provides the mechanism for the total dollars collected from the marketplace from Class I, II and III sales to be put into one pool and be shared equitably among each hundred pounds of milk marketed. This provides the assurance to dairy producers they will share equitably in the market.

Marketing orders, in order to verify usages in the various classes of products, audit handlers records and verify that finished products going to consumers meet minimum requirements. This function also provides important market information concerning trends in sales, uses, and milk supplies for the use of producers, handlers, and consumers.

While marketing orders provide these benefits, they do not guarantee markets, they do not guarantee minimum price levels, and they do not limit competition. Market orders arrive at a minimum order blend price to be paid to dairymen, however each handler can pay more depending on their own profitability. Indeed, it can be argued that competition is enhanced by all parties having access to the marketing information and statistics provided by the order. All this provides the milk producer an orderly market for a very perishable product, which in turn achieves the ultimate goal, a constant and adequate supply of pure and wholesome dairy products for the consuming public.

Kansas needs this legislation now because:

1. The Federal Order Program could be terminated at any time as evidenced by the recent cancellation of a navel orange marketing order in the Southeast late last year. The U. S. Secretary of Agriculture can cancel any federal marketing order with the stroke of a pen, and the Kansas Dairy Industry needs more assurance than that.
2. There may be need to establish a more favorable pricing system applicable to milk sales in Kansas, to create a more stable milk market and assure consumers of a steady and dependable supply of high quality dairy products, while encouraging those in the industry to remain in the state. This is legal and within ICC regulations as evidenced by various other state orders being tested and upheld by the courts.
3. Marketing conditions change frequently giving rise to the need for expedited changes in milk marketing regulations applicable within the State. A state order could be implemented by the board upon their approval and the majority vote of dairy producers within the state. Implementation could be prompted by the present Federal Milk Order system being terminated, or it could be implemented on top of current Federal Orders should the board decide the present Federal Order system had been rendered ineffective. The State order could be amended or terminated upon the approval of the advisory board and a majority vote of Kansas dairy producers.

The dairy industry in Kansas employs thousands of people all along the production and marketing channel, involving farmers, milk haulers, milk processors, and delivery personnel. Others in the feed, supply, chemical, fertilizer, equipment and packaging fields, etc., are employed to service the dairy industry. Total milk and related service payrolls are in the hundreds of millions of dollars annually.

Therefore, need exists for the legislature to enact this legislation to maintain and improve the value of agricultural assets which assist the economic structure of communities throughout the state.



ANDERSON ERICKSON DAIRY CO.

Testimony of Anderson Erickson Dairy Regarding Senate Bill Number 72

This testimony is presented on behalf of Anderson Erickson Dairy Company in opposition to Senate Bill No. 72. I am James W. Erickson, President of Anderson Erickson. At the outset I would like to note that I only heard about this hearing on Friday, February 12; my preparation has necessarily been limited by that short notice.

I would like to request that any further action on Kansas Senate Bill No. 72 be delayed until after March 9, 1993, since industry leaders including Mid-Am and myself are meeting in Washington D.C. to try and resolve the issue of state orders. My understanding is that at least one state adjacent to Kansas has agreed to this request already.

Senate Bill No. 72 is another effort by Mid-America Dairymen to legislate higher prices of milk. Last year, the industry was forced through another series of state legislative hearings on similar revenue enhancing schemes hatched by Mid-America. Last year's series of bills were unmanageable and would have caused severe economic dislocations for anyone involved in the dairy industry in Kansas and Missouri. Fortunately those bills were defeated or withdrawn. Unfortunately we are back again today with more unmanageable and uncompetitive ideas. We do not dispute the laudable goals of Mid-America Dairymen -- the methods proposed to be used, however, are extreme and, if implemented as we suspect, most likely would violate the United States Constitutional protections for interstate commerce.

Anderson Erickson is a family-owned dairy located in Des Moines, Iowa, which has engaged in the business of distributing packaged milk for 63 years. I joined the dairy in 1958 and, over the years, have been involved in every aspect of its operations. My responsibilities have required me to become familiar with the

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terms and operations of the Federal Milk Marketing Order system, upon which Senate Bill No. 72 is modeled. I am also very familiar with the marketing areas in which we distribute our milk, including Kansas and Missouri.

One thing is abundantly clear, we and others routinely sell packaged fluid milk into a number of different states. I also know that others from outside Kansas sell milk into Kansas. Similarly, Kansas processors can and do routinely sell significant quantities of milk into other states such as Iowa, Oklahoma and Missouri.

These facts are important because we already have a federal milk order system that sets minimum prices for dairy farmers' milk. These prices for fluid milk are, however, based upon an unregulated price for raw milk used to produce surplus dairy products such as cheese, butter and powder. Fluid milk then has a add-on price, significantly above the surplus milk price. This federal minimum price can be, and usually is, only a starting point for the actual prices charged to processors.

Cooperatives and other independent dairy farmers are able to extract premiums for their milk, making the final price for raw milk used for fluid consumption higher than either the surplus price or the minimum federal price. However, we deem the current system to be based upon market conditions, including supply and demand conditions. We also pay an administrative assessment to fund the federal program.

If Senate Bill 72 passes, we would be subject to yet another regulatory program including additional administrative assessments.

Why? Mid-America says that it is trying to be prepared for the possible termination of federal orders. There is no reason to believe that federal orders are in jeopardy. On February 5, 1993, the United States Department of Agriculture issued a lengthy final regulatory decision reviewing the entire federal milk order system and reaffirming, in the face of significant opposition, the validity, purpose and operation of the federal orders. That decision followed 43 days of regulatory hearings, including 10,000 pages of transcript, over 200 voluminous exhibits, and thousands of pages of officially noticed documentation. There is no reason to believe that that decision can or will be reversed anytime soon.

We ask whether the purpose of Mid-America's proposal, like last years, is to extract more money from fluid milk consumers in Kansas so that dairy farmer incomes can be enhanced. If so, we believe that the law of supply and demand ought to govern, not the law of whatever price Mid-America thinks it should be. Higher prices to consumers can result in less consumption and even lower prices to producers.

In addition, the federal program that the Mid-America program is designed to emulate employs hundreds of employees in Washington, D.C., Kansas, Iowa and elsewhere. The regulatory program is frequently subject to extensive administrative review and court challenge -- all of which costs the industry and taxpayers substantial sums of money. Another expensive layer of administrative personnel is unnecessary.

Another requirement of the proposed legislation is to consider Kansas costs of production data in establishing the price for fluid milk. The issue of costs of production was extensively aired during the 43 day federal order hearing which I mentioned earlier - all available cost of production data was made a part of that record. However, cost of production data currently collected is unreliable for considering milk price levels because the methods of collecting the data and reporting the data vary greatly. Indeed in that 43 day hearing we, together with many others, challenged the validity of such data in setting the price for fluid milk. The United States Department of Agriculture formally agreed with our position in its recently published final decision:

The AE [Anderson-Erickson], et al., exception urged that costs of production evidence should be declared unsuitable for use as a milk pricing factor. We agree, but only to the extent that the data provided in this record could not appropriately have been used to establish milk prices under the Federal order program.

One of the major problems identified with costs of production data is the existing interrelationship between costs and prices. Unchallenged studies show that higher costs of production follow higher prices and that lower costs follow lower prices. If you attempt to reverse this relationship by having costs determine price, a never ending upward price spiral will result. To see why this is true simply imagine that under the proposed program, a \$13 per hundredweight ("cwt") cost of production results in a price of \$14 per cwt of milk. Cornell and University of Wisconsin studies show that a dairy farmer's cost of production will rise towards the

\$14 level. Now your program will cause the price level to rise further say to \$15 per cwt. Costs will then follow this \$15 cwt price. These studies are undisputed.

Since the Kansas program would emulate the federal program and since the federal authorities could not, after extensive hearings, use costs of production data for pricing milk, Kansas should not second guess the federal authorities on this issue. Costs of production data is simply too unreliable and too old (often lagging at least one year) to be an honest and significant factor in pricing milk.

The last problem that I want to discuss today is also the biggest problem with state orders in general and the proposed Kansas statute in particular. Unlike federal orders, state orders have major difficulty in regulating the price of milk in interstate commerce. It is not clear to me that Kansas would attempt to regulate such prices, but if you do not attempt to regulate interstate shipments, Kansas processors will lose business to other states. However, if Kansas does attempt to regulate the price of milk from Iowa or elsewhere, I am convinced that those efforts are unconstitutional.

Two federal courts in New York and Minnesota have recently held that such efforts to regulate interstate milk shipments are simply and clearly violative of the interstate commerce clause of the United States Constitution. On December 23, 1992, United States District Court Judge Doty enjoined Minnesota from collecting any payments on purchases of out-of-state milk by Minnesota dairy

processors. See, Decision and Order of December 23, 1992, Marigold Foods, et al. v. Redalen, Civil No. 4-92-1084 (District of Minnesota, Fourth Division, 1992). After the federal court decision in New York (Farmland Dairies v. McGuire, 789 F. Supp. 1243 (S.D.N.Y. 1992)) was issued, the state of Connecticut voluntarily suspended its similar state program in order to obtain dismissal of another lawsuit filed in that state. Yet another older case decided by the United States Court of Appeals for the 5th Circuit further illustrates my point. In that case, higher milk charges were assessed by the state of Louisiana against instate and out of state processors of milk. The extra fee charged on out of state wholesalers bringing in packaged milk violated the interstate commerce clause. Louisiana Dairy Stabilization Board v. Dairy Fresh Corp., et al., 631 F.2d 67 (5th Cir. 1980), aff'd without opinion 454 U.S. 884 (1981). Another case on similar issues is still pending in Massachusetts. We do not think that Kansas taxpayers will want to fund such fruitless litigation.

Since the proposed law cannot work in the absense of an unconstitutional restriction on the movement of fluid milk, it should not be enacted at all. We need constructive and thoughtful solutions to issues affecting the entire dairy industry, not proposals which merely promise results to producers and then fail to deliver because of obvious legal deficiencies.

Thank you for your time and consideration.