STATEMENT OF EARL FINK
ON BEHALF OF THE PENNSYLVANIA ASSOCIATION OF MILK DEALERS
BEFORE THE PENNSYLVANIA MILK MARKETING BOARD ON MAY 16 2018

Chairman Brubaker and members of the Board - good morning. My name is Earl Fink. I am the executive vice president of the Pennsylvania Association of Milk Dealers, an association of fluid milk processors who process the majority of milk sold in the Commonwealth. We currently have 22 members with 19 fluid milk plants in the state.

I have been involved in the state's dairy industry since 1971 when I started working for the Milk Marketing Board as an auditor and later as Executive Secretary. The conditions we are seeing today are unprecedented.

Milk production has exceeded market demand by a huge amount. In the past few years we have seen milk (often skim) being underutilized and at times dumped in this region because supply is exceeding demand in the face of declining fluid milk sales and there is not sufficient manufacturing capacity to handle the milk. In addition, the milk price has demonstrated significant swings from over $24 per hundredweight in 2014 to just over $15 recently.

For the first time in my experience, cooperatives are not taking on farmers who have lost their market. One thing that is different about the current situation is the lack of federal intervention. In the past, when there have been major supply and demand imbalances, the federal government had more direct involvement with price support and the whole herd buy outs, among other programs.

This is not a Pennsylvania problem it is a national and even an international problem. In my opinion, it cannot be solved by Pennsylvania or any other state both due to the scope of the problem and due to the limitations the U.S. Constitution imposes on states in their ability to regulate interstate commerce.

Having said that, the Pennsylvania Milk Marketing Board ("PMMB") is clearly a benefit to the Pennsylvania dairy industry, Pennsylvania's farm numbers, plant numbers, and diversity of retailers reinforce that the Milk Marketing Board helps the Pennsylvania dairy industry. For instance, as of 2017 the most recent year for which annual data is available, Pennsylvania has the second highest number of dairy farms in the United States, second only to Wisconsin. Between, 2010 and 2017, Pennsylvania saw the smallest decrease in the number of dairy farms in the United States. And, in the same time period, Pennsylvania with an average farm size of 80 (versus the next smallest average of 139 in New York and 141 in Wisconsin) saw a modest increase in production per cow of 5 percent. (See Attachment A). This is clearly an indication that the Pennsylvania Milk Marketing Board is doing something that is helpful.

I am a firm believer that the Pennsylvania Milk Marketing Board has and will continue to help all segments of Pennsylvania's dairy industry and that major policy changes to the Milk Marketing Law pursued as a result of this crisis will not stand the test of time and would likely create unintended consequences, especially given the complexities of the economic regulation of dairy and the fact that raw milk and packaged milk continues to move greater distances.

It was recognized long ago by a Federal Court of Appeals and still holds true today as a caution against change without serious consideration of the unintended consequences that "[t]he milk problem is so vast that fully to comprehend it would require an almost universal knowledge ranging from geology, biology, chemistry and medicine to the niceties of the legislative, judicial and administrative processes of government." Queensboro Farms v. Wickard, 137 F.2d 969, 975 (2d Cir. 1943). I would like to add that it also really requires major knowledge of accounting and economics.

I think it is important to outline for those that criticize the Milk Marketing Law some of the ways in which the resultant actions of the PMMB positively reach the varying segments of the dairy industry. I am attaching bullet points that I believe are important to a proper understanding of the ways in which the PMMB works and I wish to highlight separately a few points in these remarks. (See Attachment A).

For our membership, despite the misconception, the PMMB system does not guarantee a profit to all plants, but it provides some benefits that in many cases are indirect in the nature. Like dairy farmers, fluid milk plants have needed to engage in other lines of business to cover their overhead. Among other reasons, the Milk Marketing Board, through its Staff initially when auditing cross section milk plants for the cost build up that is used to set the wholesale minimum price, endeavors to strike a balance between helping milk plants cover their costs and keeping the milk price competitive by excluding some costs from the cross section build up.

As a result, the wholesale minimum prices *do not* cover *all* of the costs in the cross section cost build up. Also, the cost build up is generally at least a year old and in some cases even older. This means milk plants operating today are selling at wholesale prices that are based on costs that are a year or more stale. Moreover, even if wholesale prices were not based on older costs, it would only be the perfectly averagely efficient milk dealer that could achieve the intended rate of return, but many milk dealers, including those higher cost milk dealers in the cross section and out of the cross section, do not even receive the established rate of return.

This means that the wholesale minimum prices are *not* set so that every milk dealer is profitable. Thus, in order to address these limitations of the system, milk dealers have, not unlike dairy farmers, had to develop other revenue streams including sales outside of Pennsylvania and the sale of non-dairy drinks.

Based on the most recently available audited annual reports submitted by milk dealers for 2016, cross section milk dealers showed a wide range of profitability. Many were negative and some were positive but the vast majority were well below the 2.5% to 3.5% that onlookers erroneously believe is guaranteed. I therefore wish to dispel the myth that milk dealers are guaranteed a profit. If that were true, the 54 fluid milk plant members of PAMD that were in business when I joined PAMD in 1983 would still be in business, but instead today we are down to 19 member fluid milk plants.

Having outlined the limitations of the Milk Marketing Law for fluid plants, PAMD takes a broader view and concludes that the wholesale minimum price at least helps our fluid plants to recover the over-order premium in our dealings with Pennsylvania retailers, helps retailers to avoid selling milk as a loss leader and therefore discourages retailers from forcing fluid milk plants to sell milk at bottom-of-the-barrel pricing such that our milk dealers have a fighting chance to stay afloat by increasing volume and adding additional product lines.

Like farmers, the benefits of the PMMB system for fluid milk plants are not necessarily direct in all cases, but given where milk pricing is in other states - for example 98-cents per gallon - PAMD believes the PMMB system is still better than the alternative. We think that those that criticize the current system and want change because we are experiencing a crisis should step back and consider the broader picture because there are similar stabilizing benefits for retailers and farmers that should not be ignored.

At the last session on May 2, 2018, retailers testified that they wish to retain the retail minimum prices in order to avoid having to sell milk as loss leaders and one farmer representative turned that on its head with a criticism that the Milk Marketing Law is benefiting someone - the retailers - but not him. He is not alone in his views, but I feel strongly that there is so much more to the story than he and his fellow dairy farmers are recognizing.

If stores have to sell milk as a loss leader - that means they will sell the milk below cost and actually lose money on that milk. They will have to charge higher prices on other grocery items to make up the loss and/or they, like large retailers, will be forced to also reduce the size of the "loss" on the milk by seeking the cheapest milk. That may mean out-of-state milk or milk with no over-order premium. Worse still, smaller retailers may not be able to absorb the losses on milk sales due to their smaller size and we believe eventually will follow trends elsewhere and succumb to large national retailers.

No Pennsylvania dairy farmer, whether shipping to a manufacturing plant or a fluid milk plant or to a cooperative would benefit from either of those results because cheaper milk means lower or no over-order premium, which has historically served as a competitive benchmark for buyers of other classes or from nearby. Stores buying out of state milk means PA plants have lower volume, cannot cover their costs, and may go out of business, notwithstanding PMMB's wholesale minimum prices and that means fewer nearby Class I outlets for Pennsylvania dairy farmers and less competition forcing nearby manufacturing plants to pay premiums.

Fewer fluid milk plants in Pennsylvania means fewer potential Class I-paying customers and less competition for raw milk supplies. Fewer fluid milk plants means farmers or their cooperatives competing to ship longer distances with higher logistics costs, or fewer Class I outlets for Pennsylvania farmers. Fewer class I outlets for dairy farmers in federal milk marketing order 1 (the Northeast Order) means lower blend prices for all.

We urge the PDA, the Milk Marketing Board, Industry and the Legislature to be cautious. Despite some painful times, Pennsylvania farmers and plants seem to have been able to weather the volatility over the years better than farmers and plants in a number of other states from a statistical standpoint. Changing the current system during a time of crisis would in our view lead to unintended consequences since the dairy industry is one of the most complex, interrelated and somewhat delicate industries to regulate.

PAMD believes that instead of asking what more can the Milk Marketing Board do, PDA should work on ideas that can be achieved without disrupting what positives the industry derives from the Milk Marketing Board. For instance, we think it is important to keep pushing for whole milk or at least milk with more milkfat in schools and PAMD intends to advocate for this. If we lose school children, consumption will continue to decline, a net bad for our industry and the health of Pennsylvania's school children. The legislature could also help farm families have more resources to invest in farm management or the physical farm with various tax changes. For instance, if the farm has a loss and they have income off-the-farm, they cannot presently, but should be allowed to, offset the off-farm-income. Also, Pennsylvania could help dairy farmer tax payers by allowing the expensing of equipment purchased instead of using the state depreciation method, and in turn accelerate the ability to benefit from such write offs. PAMD thinks that PDA's petition is too narrowly focused on the Milk Marketing Board and would in some cases unnecessarily expose the Milk Marketing Board to potential litigation.

Thank you for the opportunity to contribute to this discussion on behalf of the Pennsylvania Association of Milk Dealers.

PMMB Producer, Wholesale and Retail Minimum Prices Foster
A Strong Dairy Industry Infrastructure in Pennsylvania

According to U.S. Department of Agriculture data for 2017 (**See Image 1**), the Commonwealth of Pennsylvania and the Pennsylvania Milk Marketing Board (PMMB) is helping to preserve Pennsylvania dairy farms.

- PA has the SECOND most dairy farms in the United States at 6,570.
- PA lost the FEWEST dairy farms on a percentage basis versus other major milk producing states.
- PA has the SMALLEST average herd size at 80 cows.
- PA milk production is still increasing – an increase of 5.0% over 2010-2017, which is typically a sign that dairy farming remains viable.

The PMMB's minimum Farm, Wholesale and Retail prices (the Three-Legged Stool) work together to provide a hospitable environment for diverse dairy farmers and maintain strong dairy farm numbers.

- States like New Jersey, Alabama, and Louisiana, which have abandoned PMMB style minimum price regulation have long seen their dairy infrastructure in decline. New Jersey for example now has fewer than 65 dairy farms, has only three large-scale fluid milk plants and largely imports their milk.
- In contrast, Pennsylvania has in excess of 6,000 dairy farms and over 20 fluid milk processing plants.

A rich tapestry of fluid milk plants provides PA dairy farmers with nearby access to the lucrative fluid milk market and due to proximity offers opportunities to minimize hauling costs generally incurred by producers.

- Fluid milk plants pay the highest federal minimum price because of the Class I differential. ALL dairy farmers (including those whose milk goes out of state or to manufacturing) benefit from the increased value of the Federal Milk Marketing Order (FMMO) blend price.
- FMMOs with higher Class I pay a higher pool blend price than FMMOs, all other things being equal.
- Fluid plants have historically paid higher voluntary premiums for quality and a steady supply.
- Fluid plants pay the PMMB Over-Order Premium (OOP) on milk that is PA produced, processed and sold.
- The OOP serves as a benchmark against which non-fluid and out-of-state plants must compete and the OOP has historically tended to raise premiums to farmers not eligible for the OOP directly.
- The OOP has historically been maintained at higher levels than premiums in surrounding states.

PMMB enables fluid plants to remain financially viable by requiring packaged fluid sales at prices that cover the cost of a representative cross section and a return, so that efficient plants can earn a profit.

- In other states, the absence of wholesale minimum price regulation has enabled retail and food service companies, to push for prices that are below a fluid milk plant's costs.
- Many plants have to agree to these unfavorable terms to keep their plants full in order to cover their overhead and try to make it up elsewhere.
- It is not uncommon to see gallons of milk selling for less than a dollar per gallon in states without Pennsylvania-style minimum price regulation.
- In July of 2017, Aldi's was selling gallons for 98-cents per gallon in Maryland. (**See Image 2**) That would be $11.37 cwt, substantially less than the cost of raw milk, let alone the cost of processing, packaging and delivery.
- Retail stores and food service providers are larger than ever before, so wholesale minimum prices serve as a critical constraint against Pennsylvania fluid plants being forced to sell milk unsustainable prices.

Retail minimum prices serve as a check on stores to prevent them from using milk as a loss leader in the increasingly competitive retail space.

- If stores (and food service vendors) are unable to use milk as a loss leader due to retail minimum prices, they do not have the incentives that exist in other states to require unsustainable pricing.

PMMB Producer, Wholesale and Retail Minimum Prices Foster
 A Strong Dairy Industry Infrastructure in Pennsylvania

Producer, Wholesale and Retail Minimum Prices benefit dairy farmers AND consumers. The Federal District Court for Middle District of Pennsylvania and Third Circuit Court of Appeals have recognized that:

- Fluid milk plants and retailers must be able to recover the cost of the Over-Order Premium so they have the wherewithal to pay it and other premiums to dairy farmers.
- The minimum prices serve as a constraint on above minimum pricing since a published minimum price informs stores and consumers that there is a price they do not need to exceed without special justification (e.g., service, preference, special circumstances).
- PMMB's three-tiered system of minimum pricing has been shown to work together so that producers receive a larger share of the retail dollar in Pennsylvania than in states that do not have three tiers of pricing and that consumers have enjoyed lower prices when adjusted for location differences.

The PMMB positively impacts the entire farming infrastructure.

- Strong dairy farm numbers enable feed companies, equipment sellers, service companies, hoof trimmers, nutritionists, fertilizer companies, seed suppliers, and veterinarians, among others, to operate nearby thereby offering cost-effective and convenient service for PA farms generally.
- More dairy farmers provide a buffer for other farms against urban sprawl.

Image 1 – PA Has Shown Resiliency As Major Milk Producing States Have Lost More Dairy Farms On A % Basis

	Number of farms 2017	Percentage decrease in number of dairy farms 2010-2017	2017 production (millions of pounds)	2017 average herd size/farm	2017 milk/cow (lbs)	Percentage increase in production/cow 2010-2017
California	1,390	19.0	40,683	1,258	22,755	-1.2
Wisconsin	9,090	28.5	30,320	141	23,725	15.0
New York	4,490	16.5	14,912	139	23,936	15.0
Idaho	510	12.8	14,627	1,176	24,378	4.8
Michigan	1,750	21.5	11,231	244	26,302	13.0
Pennsylvania	6,570	10.5	10,938	80	20,834	5.0
Texas	400	32.2	12,054	1,278	23,589	10.4
United States	40,219	24.3	215,466	234	22,941	8.5

Image 2 – Gallons Sold At Aldi's (Frederick, MD) July 2017 and at Meijer (Avon, IN) October 2017 For Less Than The Cost Of The Raw Milk. *MD and IN do not enforce wholesale or retail minimum prices*