

SUBJECT: Ratification of the Southern Dairy Compact

COMMITTEE: Agriculture and Livestock — committee substitute recommended

VOTE: 6 ayes — Swinford, McReynolds, B. Brown, Christian, Hardcastle, Hupp
2 nays — Green, C. Jones
1 absent — Crownover

WITNESSES: For — William De Jong, Texas Association of Dairymen and Elite Milk Producers; Danny Evans, Texas Farm Bureau and Texas Dairy Coalition; Mark Hannan, Dairy Farmers of America; Mae Schmidle, Northeast Dairy Compact; Don Smith, Premier Milk Producers; Robert Wellington, Agri-Mark Dairy Cooperative; Hope Huffman; Mal Machado

Against — Bill Armstrong, Americana Foods; Glenn Brown, Dairy Products Institution; Chuck Courtney, Texas Retailers Association; Martin Devine, Suiza Foods; Charles English, Jerry Frie, Wendy Yoviene, Southern Food Groups; Paul Kruse, Blue Bell Creameries; H. Lee Richards, Hygeia Dairy Co.

On — Reggie James, Consumers Union; Ron Knutson, Agriculture and Food Policy Center; Ray Perryman

BACKGROUND: Following years of steady growth, Texas has lost about one-third of its dairy farmers and one-tenth of its milk production since 1995, according to the U.S. Department of Agriculture (USDA). This loss has lowered Texas' national ranking in milk production from sixth to seventh.

Southern milk-producing states have formed the Southern Dairy Compact, contingent on passage of federal legislation. Fourteen southern states other than Texas have ratified the text of the compact, which calls for a minimum-price system for fluid milk in the compact region.

DIGEST: CSHB 2000 would provide for Texas to enter into the Southern Dairy Compact once:

- ! the governor has executed the compact on behalf of the state and filed a verified copy of the compact with the secretary of state;
- ! the U.S. Congress has consented to the compact; and
- ! two or more other states have ratified the compact.

CSHB 2000 would enact the entire text of the Southern Dairy Compact into state law.

CSHB 2000 would require the agriculture commissioner or a designee to serve as the chair of Texas' five-member delegation to the Southern Dairy Compact Commission or to appoint a delegate employed by the Texas Department of Agriculture to serve as the chair. The governor would appoint the other four delegates, of whom two would have to be dairy farmers, one a dairy processor, and one a consumer representative. All would have to be Texas residents and registered voters. Each delegate would serve four years or until a successor was appointed and qualified. No one could serve more than three consecutive terms as a delegate.

Among many other provisions, the text of the compact would declare that the compact's purpose is to form an interstate commission region that would sustain the viability of dairy farming in the southern region and would assure consumers of an adequate local supply of milk. The text would state that the participating states find that dairy farms are essential to the region's rural communities; that it is in the public's interest to regulate the price of milk; and that federal minimum prices do not preempt the power of the states to regulate milk prices above those minimum levels.

The bill would define "Class I milk" as fluid milk and the "compact over-order price" as the minimum price to be paid to producers of Class I milk that is above the price established by federal marketing orders or by state farm-price regulation in a regulated area.

The text would declare the compact's constitutional regulatory authority over the region's Class I milk market and would reserve the authority to replace the federal market-order pricing system for all classes of milk if the federal system pricing was discontinued.

Regulations issued or amended by the compact commission establishing an over-order price or a commission marketing order, including any provision affecting milk supply, would have to be approved by milk producers in a referendum. Approval would require a two-thirds vote. The compact commission could terminate an over-order price or marketing order whenever it found that a majority of producers favored it.

Among other provisions, the text would provide that:

- ! dairy processors in the compact could be levied an assessment of not more than 1½ cents (\$.015) per hundred-weight of milk to finance the compact's over-order pricing system; and
- ! if Texas wished to remove itself from the compact, the state would have to provide a year's notice to the compact commission.

CSHB 2000 would take immediate effect if finally passed by a two-thirds record vote of the membership of each house.

**SUPPORTERS
SAY:**

CSHB 2000 would empower the governor to enter Texas in the Southern Dairy Compact, enabling Texas dairy producers to reap the benefits of the compact. The bill would authorize Texas to send a five-member delegation to represent the state in the Southern Dairy Compact Commission. If Texas dairy producers cannot participate in the compact, they will continue to experience declining milk prices under the federal government's market-order pricing system. These declining prices would have a devastating effect on dairy farmers, putting many out of business.

Texas is the only eligible state that has not yet enacted legislation authorizing the state to join the compact. Upon enactment of CSHB 2000, Texas would join 14 other southern states in the compact. The compact would implement a minimum-price system only for fluid milk in the compact region. This would stabilize milk prices, because the price of fluid milk is much more consistent than that of other classes of milk.

The federal pricing system, which is based on cheese, fluctuates greatly, especially since the government has stopped buying excess cheese. The pricing system under the compact would allow southern dairy farmers to be paid on the basis of the more consistent sales of fluid milk. Most milk in

Texas is used for drinking, not for making cheese.

If the Legislature chooses to wait two more years before joining the compact, Texas will have lost many more dairy farmers and much more of the state's milk-production capacity. Texas dairy producers need a more realistic pricing system that reflects the Texas milk market rather than the Wisconsin cheese market. The state's entry into the compact would enable Texas dairy farmers to join other southern dairy farmers in obtaining more realistic pricing.

In 1996, Congress enacted the Freedom to Farm Act, which eliminated the federal program of buying surplus dairy products. The surplus buying program, in conjunction with the federal pricing formula, had prevented extreme swings in the prices of dairy products. The 1996 law has resulted in unstable prices for dairy farmers in the southern states because the federal pricing formula was not modified.

It might seem that the obvious solution for all of the nation's dairy farmers would be to restructure the federal market-order pricing system. However, USDA has refused to acknowledge the needs of southern producers. In fact, USDA is going in the opposite direction, to the detriment of Texas and other southern states. The best response is for southern states to form a compact to address their regional needs.

USDA has announced a new rule to be implemented October 1, 1999, that would restructure the federal pricing system. Upon examination of the new system, producers in Texas and other southern states have determined that raw milk prices will erode even further and that southern dairy farmers will suffer if they stay under the federal pricing system.

Texas produces \$1 billion worth of milk per year, yet the state produces only enough milk to satisfy half of its own consumption of dairy products. As a result, Texas depends on imported milk to meet its total demand. While some may cite increased consumer prices as a reason not to join the compact, consumers actually will be protected only if Texas joins the compact. If Texas does not enter the compact, Texas milk will leave the state to seek the higher prices in neighboring compact states, and much of the milk that has been coming into Texas from New Mexico will bypass Texas for more stable and higher prices in compact states to the east.

Over the next 25 years, Texas' population is expected to grow by 35 percent. Milk importation needs are likely to grow as time goes on. Texas consumers could see their milk prices rise dramatically if the state must import large amounts of milk and processors must bring in raw milk from great distances.

If Texas' supply of milk is further reduced, the cost of imported milk will be reflected in higher consumer prices. On the other hand, if Texas joins the compact, more Texas milk will stay in the state to meet consumer needs, and the compact's stable prices will prevent a growing reliance on imported milk.

The Northeast Dairy Compact already has begun operation. The retail price of milk in that region went up 20 cents per gallon for about six months after the compact's effective date. During the same period, the retail price per gallon of milk in Dallas rose by 40 cents. Obviously, participation in a minimum-price compact has nothing to do with the retail price of milk. In fact, a U.S. General Accounting Office report to Congress showed only a 3 percent correlation between the farm-level price of milk and the retail price from January 1996 to February 1998. This correlation is statistically insignificant, indicating that the retail price of milk bears no relation to the cost of producing milk.

Grocery stores finally determine the price consumers pay for a gallon of milk. All grocery stores use milk as a "loss leader" to attract customers with competitive, low milk prices. Customers in Texas will not end up paying more for milk if the state enters the Southern Dairy Compact because normal retail price competition among stores will keep the consumer price low.

Dairy processors who may oppose CSHB 2000 are being short-sighted because in the long run, a plentiful local milk supply, such as the compact would ensure for participating states, will keep processing costs down. If Texas does not enter the compact, eventually dairy farms will shut down, dairy cows will go out of state, and local milk will be moved out of state for processing. All of this would hurt the business of Texas dairy processors, who would have to import milk to keep their processing plants operating.

**OPPONENTS
SAY:**

Texas' entry into the Southern Dairy Compact, which CSHB 2000 would authorize, would result in dairy processors paying more to milk producers than they now pay. This price increase ultimately would be passed on to the consumer, raising prices in the grocery store. Milk-consuming programs like Women, Infants, Children (WIC) would be protected from a price hike, but

other bulk consumers like schools and hospitals are not mentioned specifically in the compact and might not be protected. Price increases for these groups, especially schools, could hurt school lunch programs.

Consumers also would pay more ultimately because each increase in the minimum market-order price would be passed on to consumers, but if the price floor declined, the decrease would not have to be passed on to consumers.

Entering the compact might be commendable if it would keep small dairy farmers in business, but the trend with or without the compact is toward bigger dairy operations. If small dairy farmers cannot weather the federal market-order price fluctuations now, they will not be able to stay in business for the next few years until the Southern Dairy Compact is approved and put into motion.

Congress passed the Freedom to Farm Act with the intention of phasing out government involvement with farm prices. Creating a regional compact simply would add another barrier to reaching a free market system. Although dairy market prices are extremely volatile now, adding more bureaucracy is not the way to fix them. Good government policy would be to seek a long-term solution rather than a quick fix like the Southern Dairy Compact. The long-term solution may well be to allow the dairy industry operate in the free market system like other businesses.

Texas already has the option of implementing dairy market-order price floors within the state. Before or instead of joining the compact, Texas should try an internal pricing system that the state could modify or eliminate more easily if necessary. At the least, CSHB 2000 should contain a sunset provision so that the Legislature could reexamine compact membership in the future.

NOTES:

The committee substitute amended the original bill to require, rather than authorize, the agriculture commissioner to chair Texas' delegation to the compact commission or to appoint a designee.

The companion bill, SB 737 by Armbrister, has been referred to the Agriculture Subcommittee of the Senate Natural Resources Committee.