SB 285

Department of Legislative Services

Maryland General Assembly

FISCAL NOTE

Senate Bill 285 (Senator Derr, *et al.*)(Western Maryland Senators)
Economic and Environmental Affairs

Northeast Interstate Dairy Compact

This bill enters Maryland into the Northeast Interstate Dairy Compact and makes it a member of the Northeast Interstate Dairy Compact Commission. The commission is authorized to establish a minimum price to be paid to milk producers by milk distributors (compact over-order price). The bill establishes certain requirements on the calculation of the compact over-order price. In addition, the commission may conduct various studies on dairy industry costs and economic conditions.

Fiscal Summary

State Effect: State finances are not directly affected. The Northeast Interstate Dairy Compact Commission is funded through an assessment on milk handlers.

Local Effect: None.

Small Business Effect: Meaningful impact on small businesses if Congress reauthorizes the Northeast Interstate Dairy Compact to include Maryland.

Fiscal Analysis

Background: The 1996 federal farm bill authorized the U.S. Secretary of Agriculture to grant six New England states the authority to enter into a regional dairy compact (Northeast Interstate Dairy Compact). The federal law permitted six other states to join the compact; however, congressional approval is required and each state must be contiguous to a state already participating in the compact. Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont have already joined the compact, with several other states in the process of joining. Since member states must be contiguous, Pennsylvania and New York must join the compact before Maryland can join, unless Congress eliminates this provision when the compact comes up for reauthorization.

Bill Summary: This bill enters Maryland into the Northeast Interstate Dairy Compact and makes it a member of the Northeast Interstate Dairy Compact Commission.

Commission Membership

The State's delegation to the compact commission includes five members: two dairy farmers, two consumers, and one dairy processor. Members are appointed by the Governor to four-year terms. A member may serve for a maximum of three consecutive terms. Members may not receive compensation, but are entitled to expense reimbursements under the standard State travel regulations.

Commission Responsibilities

The commission can: (1) establish a compact over-order price (a minimum price required to be paid to farmers which exceeds the minimum price established in the federal marketing order); (2) prepare model dairy laws and regulations for compact members; (3) investigate dairy industry costs; (4) examine current economic forces affecting the dairy industry; (5) review and propose changes to existing milk marketing systems; (6) prepare and release periodic reports on commission activities; (7) conduct cost-benefit analysis reports of potential dairy programs; and (8) encourage the harmonious relations between the various elements of the dairy industry. The commission, with respect to milk handlers, must enforce the provisions of the compact, regulations establishing an over-order price, and other regulations by taking legal action in State or federal court.

Commission Funding

The Northeast Interstate Dairy Compact Commission is funded through an assessment on milk handlers. The commission can borrow money and issue notes; however it cannot pledge the credit of any participating State or of the United States. Financial obligations are the sole responsibility of the commission.

State Effect: General fund expenditures may potentially increase by an indeterminate amount if establishing an over-order compact price increases milk cost. The Department of Health and Mental Hygiene, the Division of Correction, and the Department of Juvenile Justice purchase approximately one million gallons of milk annually. Accordingly, State general fund expenditures could increase by $10,000 for each penny increase in the price of a gallon of milk. As stated in the small business effect section, it is unclear whether establishing an over-order milk price would increase milk prices. Other factors, including retail price mark-ups, distribution costs, and profit margins, could influence consumer milk prices to a greater extent than the price paid to dairy farmers. In addition, the compact commission has the authority to reimburse certain organizations (such as local school systems) if the price of milk increases.

Small Business Effect: Maryland's dairy industry is concentrated in the north-central section of the State, with Frederick, Washington, and Carroll counties accounting for nearly two-thirds of the State's milk production. However, dairy operations exist in a majority of the State's counties.

There are approximately 860 commercial dairy farmers in the State. These farmers generated approximately $185 million in cash receipts in 1997. The dairy industry stimulates economic activity on many different levels including veterinary services which are mostly performed by small businesses, milking equipment sales and services, and milk distribution. In 1996, 14 manufacturing plants in Maryland and the District of Columbia processed farm milk into a variety of dairy products. Based on a 1992 study, milk processing plants in Maryland employed over 1,900 people and supplied consumers with approximately $743 million worth of dairy products. Not only does the dairy industry provide jobs directly, but it spurs additional economic activity as income derived from the dairy industry is spent throughout the economy (induced economic impact). In total, it is estimated that the dairy industry provides roughly 5,300 full-time equivalent jobs throughout the State, some of which are provided by small businesses. **Exhibit 1** shows the trend in milk production and cash receipts for Maryland.

Exhibit 1
Milk Production and Cash Receipts

Year	Milk Production (million pounds)	Cash Receipts
1988	1,428	$185,640,000
1989	1,363	$197,635,000
1990	1,362	$203,588,000
1991	1,408	$183,040,000
1992	1,434	$200,760,000
1993	1,390	$186,260,000
1994	1,325	$181,525,000
1995	1,330	$175,560,000
1996	1,307	$199,971,000
1997	1,347	$185,175,000

Source: Maryland Department of Agriculture - Agriculture Statistics Service

Current Dairy Industry Trends

While dairy production constitutes the third largest sector of the State's agricultural industry, it has experienced a slowdown in recent years. The average price received by farmers for milk products has fluctuated significantly in the last 13 years as shown in **Exhibit 2**. Such instability has placed considerable fiscal stress on Maryland's dairy farmers. Since 1991, the number of dairy farms in the State has declined by around 25%. In the last year alone, an estimated 82 dairy farms closed.

Exhibit 2
Fluctuations in Farm Milk Price (per Gallon)

Year	Farm Milk Price	% Change	Year	Farm Milk Price	% Change
1984	$1.29		1991	$1.29	(12.2%)
1985	1.25	(3.1%)	1992	1.37	6.6%
1986	1.22	(2.4%)	1993	1.33	(3.3%)
1987	1.28	4.9%	1994	1.37	3.0%
1988	1.27	(0.8%)	1995	1.31	(4.4%)
1989	1.38	8.7%	1996	1.48	13.0%
1990	1.47	6.5%	1997	1.34	(9.5%)

Source: *Maryland and Virginia Milk Producers*

Economic Impact on Dairy Operations

Dairy related small businesses would be positively impacted by the State joining the Northeast Interstate Dairy Compact. Dairy farmers should realize increased revenues and profits due to the provision that enables the compact commission to establish an over-order price above the federal milk marketing order.

Currently, the United States Department of Agriculture administers the federal milk marketing order program which require processors to pay a minimum price for farm milk depending on how the milk is used. The federal milk marketing order prices are based on the market price of manufacturing milk in states such as California, Minnesota, and Wisconsin. The price for class 1 milk (milk used for fluid products) generally increases in federal market orders east of the Mississippi River proportional to their distance from the cheese manufacturing area of Minnesota and Wisconsin. This is due to the additional costs and infrastructure required to maintain a stable supply of fresh milk for the local market. There are 32 federal milk marketing orders in the country. With the exception of Garrett and

Allegany counties, Maryland dairy farmers are in federal milk marketing order number four. Due to federal legislation, the number of federal milk marketing orders will decrease in future years, as various marketing orders are consolidated.

In recent years, the federal minimum price has not been high enough to fully cover the cost of producing milk on family-sized farms in the mid-Atlantic and northeast regions of the country. This has forced many dairy farmers out of business. But since the Northeast Interstate Dairy Compact is authorized to impose a over-order price on milk production, farmers would be able to recover the full cost of producing milk assuming the over-order price is high enough. As shown in **Exhibit 3**, commission imposed over-order prices have helped to stabilize milk prices in New England states. Furthermore, as the federal minimum price increased in recent months, the difference between the commission over-order price has decreased. This shows that the commission's over-order price levels the fluctuations in milk prices so that farmers can receive an equitable price to cover farming costs. For example, in July 1997, the federal minimum price paid to farmers (federal order #1 class 1 price) was 82% of the commission price ($16.94); however, by February 1998 it was around 98% of the commission price.

Exhibit 3
Over-order Milk Prices in New England
(per hundred weight)

Month	Federal Order #1 Class 1 Price	Compact Over-order Obligation	Combined Price
July 1997	$13.94	$3.00	$16.94
August 1997	$13.98	$2.96	$16.94
September 1997	$14.10	$2.84	$16.94
October 1997	$15.31	$1.63	$16.94
November 1997	$16.03	$0.91	$16.94
December 1997	$16.07	$0.87	$16.94
January 1997	$16.20	$0.74	$16.94
February 1997	$16.53	$0.41	$16.94
Average	$15.27	$1.67	$16.94

Impact on Milk Prices

Conceptually, increasing the price paid to dairy farmers for raw milk products should increase the retail price of milk. But the actual impact on consumers depends upon the extent to which retailers absorb the higher farm milk price costs by reducing profit margins. The potential impact would also depend on the difference between the federal order minimum price and the compact price. **Exhibit 4** compares prices received by dairy farmers and Baltimore area retailers for a gallon of milk since 1984. As illustrated in this exhibit, retailers and distributors have been receiving a higher share of the revenues generated through milk sales. In 1984, the farm milk price, which is the amount received by dairy farmers, constituted 69% of the retail milk price. By 1997, this amount dropped to only 50% of the retail milk price. This shows that in the last 13 years, dairy farmers have been receiving a smaller share of the retail milk price. Further, while the average retail milk price has increased by 43% since 1984, the average farm milk price has increased by less than 4%.

Exhibit 4
Average Retail Milk Prices in the Baltimore Area and Farm Prices (per gallon)

Year	Retail Milk Price	% change	Farm Milk Price (price received by farmers)	% change	Ratio of Farm Price to Retail Price
1984	$1.87		$1.29		69%
1985	1.96	4.8%	1.25	(3.1%)	64%
1986	1.96	0.0%	1.22	(2.4%)	62%
1987	1.97	0.5%	1.28	4.9%	65%
1988	2.04	3.6%	1.27	(0.8%)	62%
1989	2.26	10.8%	1.38	8.7%	61%
1990	2.50	10.6%	1.47	6.5%	59%
1991	2.45	(2.0%)	1.29	(12.2%)	53%
1992	2.60	6.1%	1.37	6.6%	53%
1993	2.62	0.8%	1.33	(3.3%)	51%
1994	2.65	1.1%	1.37	3.0%	52%
1995	2.69	1.5%	1.31	(4.4%)	49%
1996	2.83	5.2%	1.48	13.0%	52%
1997	2.68	(5.3%)	1.34	(9.5%)	50%

Source: Maryland and Virginia Milk Producers
Retail Price Data is for Baltimore (Federal Milk Marketing Order 4 Administrator)

Exhibit 4 also demonstrates there is little correlation between the retail milk price and the price received by dairy farmers. In most years (nine out of thirteen), the increase in the retail milk price was either greater than the increase in the farm price or the decrease in the retail milk price was less than the decrease in the farm price. For example, in 1995, the milk farm price decreased by 4.4%; however, the retail milk price increased by 1.5%. In 1997, the milk farm price decreased by 9.5%, but the retail milk price only decreased by 5.3%. Since 1984, the average retail milk price has increased at 11 times the rate of the farm milk price.

Based on this information, the extent to which an over-order milk price would increase consumer milk prices is unclear. Other factors, including retail price mark-ups, distribution costs, and profit margins, could influence consumer milk prices to a greater extent than the price paid to dairy farmers.

Additional Comments: The State's dairy industry is also affected by the continual commercial and residential development of farmland. The dairy industry currently accounts for about 16% of total agricultural land use (352,000 acres). As noted earlier, approximately two-thirds of the State's milk production occurs in Frederick, Washington, and Carroll counties, with Frederick County being the State's largest producer. Based on population trends provided by the Maryland Office of Planning, Frederick County's population has increased by 106% in the last 25 years, from 85,000 residents in 1970 to 175,000 in 1995. The county's population is expected to increase by an additional 50% over the next 25 years. Currently, about 52% of the county's land area is devoted to farming. Absent a strong dairy industry in the county, a large portion of this land could be sold to developers. Entering the Northeast Interstate Dairy Compact could strengthen the dairy industry thus reducing the financial incentive to sell valuable farm land to developers.

Information Source(s): Maryland Department of Agriculture, The Library of Congress (Congressional Research Service), U.S. Department of Agriculture, Department of Legislative Services

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