FOR-3660

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BY MESSENGER

Mr. Richard M. McKee
Director, Dairy Division
U.S. Department of Agriculture
Room 2968, South Building
14th & Independence Ave., S.W.
Washington, D.C. 20250

Re: Regulating Western/Central Pennsylvania As Part of USDA's Federal Milk Marketing Order Consolidation and Reform

Dear Mr. McKee:

Milk Marketing, Inc. ("MMI"), a dairy cooperative owned by dairy producers operating out of 11 states in the midwest and the northeast[1], must express its deep concerns about, and strong opposition to, the Department's recent decision to seriously consider taking a huge step back from its May 20 proposal by leaving western/central Pennsylvania unregulated. To modify the Department's May 20 proposal to withdraw western/central Pennsylvania from regulation would perpetuate an inherently unfair and inequitable system in which a few privileged fluid milk processors receive all the benefits of federal order regulation without bearing any of its burdens. We strongly urge you to return to the path you correctly decided to travel down on May 20 and regulate western/central Pennsylvania in the mideast and the northeast milk marketing areas.

On May 20, 1997, the Dairy Division issued a revised preliminary report that proposed a consolidated and reformed federal order system that would regulate all of Pennsylvania. This report was entirely consistent with the letter and spirit of Title I, Section 143 of the Federal Agricultural Improvement and Reform Act of 1996 (the "FAIR Act"), that mandated that the Secretary consolidate and reform the federal milk marketing order system. MMI strongly favors this May 20 proposal. It directly and decisively dealt with the huge inequities created by having major portions of Pennsylvania regulated and other portions unregulated. MMI urges the Department in the strongest possible terms to proceed with this proposal and reject the substantial pressure being exerted to pull a major portion of Pennsylvania back out of the federal order system. The Department's May 20 proposal to include currently unregulated parts of western/central Pennsylvania

[1] Our producer/owners are located in the states of Ohio, Pennsylvania, New York, Michigan, Indiana, Kentucky, Maryland, Massachusetts, Vermont, West Virginia, and Delaware.

in the federal order system was undoubtedly correct. It was the right thing to do. The Department must stay the course.

Leaving western/central Pennsylvania out of the federal order system would deliver huge competitive advantages in the marketplace to a few western/central Pennsylvania processors while also granting them an unfair and inequitable "free ride" on the benefits of the federal order system. At the same time these unfair and inequitable advantages are given freely to these processors, the processors covered by the federal order are further disadvantaged because the system's costs are not shared by this large section of western/central Pennsylvania. The only way to increase the equity and fairness of the federal order system in the mideast and northeast is to eliminate this entirely unfair advantage granted to western/central Pennsylvania processors and require them to compete on equal footing with those processors located in other parts of Pennsylvania and in neighboring states.

Under a properly designed federal order system, all handlers in and around Pennsylvania would compete with each other for milk supply and for customers on a level playing field. By proposing to include the currently unregulated areas in Pennsylvania as regulated areas in its May 20 proposal, the Department recognized how fundamentally unfair and inequitable it was to permit these few handlers to operate with substantial economic advantages over their regulated competition, while they continue to receive the full stabilization and other benefits provided by the federal marketing order system.

Congress charged the Secretary with the task of not only reducing the number of marketing orders, but also reforming the marketing order system to make it more fair, more equitable, more rational, and more efficient. Including the entire state of Pennsylvania in the consolidated federal orders is a salutary way of eliminating the very real inequities in the operation and administration of the federal order system.

No USDA program should be operated to favor one group of producers or processors over another. As the milk marketing system has developed in the mideast and northeast, however, that is precisely what has come to pass. A few Pennsylvania handlers have successfully avoided federal regulation while continuing to enjoy all the fruits that such regulation brings to the domestic dairy market in which they operate. Not only have these few processors been free riders benefitting from the sacrifices and burdens being borne by others, they have used the advantages that accompany the lack of federal regulation in competing with regulated handlers for supply and for customers. In doing so, they have gained a clear economic benefit for themselves at the direct expense of the regulated handlers with whom they compete.

Under the federal order system, a handler operating in eastern Pennsylvania is required to pay a classified price for all milk that he purchases. Whether he receives the highest or the lowest classification, it is the "blend" price he is required to pay to the producer. To obtain an adequate supply of Class I milk, this handler may have to pay "out-of-pocket" premiums to attract needed supply. Now compare this to his unregulated competitor from central Pennsylvania. That processor pays Class I milk producers not a "blend" price, but a Class I price, and he does not have to pay producers additional "out-of-pocket" premiums to attract adequate supply as federally-regulated handlers do. This unregulated processor is not tied to the blend price, and if he finds a producer with superior milk, he can offer the full Class I price for that milk.

Thus, this unregulated central Pennsylvania handler has two substantial advantages over the regulated Pennsylvania handler. First, the unregulated handler is able to pay producers more for Class I milk because he pays his own "blend" price. Because he can offer more to the producer of Class I milk, he has a clear procurement advantage over the federally regulated Pennsylvania handler. Second, the unregulated handler ends up with a lower final cost for his Class I milk because he is able to pay the Class I price without the "out-of-pocket" premiums required to obtain supply under the federal system. So when he then goes to sell his milk, he has lower costs to produce it, and can offer a lower price to sell it, make at least as much profit as the regulated handler, and thereby take business away from the regulated handler without losing a penny.

Not only is the current system of federal regulation inherently inequitable, it is a system that over 550 Pennsylvania dairy producers now have petitioned the Secretary to change. That petition urges the Secretary to implement federal milk market reform along the lines of the consolidation and reform proposed by the Department on May 20. On October 30, MMI delivered a petition signed by over 550 Pennsylvania dairy producers requesting that the Department now regulate all of Pennsylvania under the federal order system. This petition dramatically demonstrates the urgent necessity of reforming the milk marketing system so that it operates for the benefit of the whole and the many, not for the benefit of the powerful and the few.

It is, of course, not just these 550 Pennsylvania dairy petition signatories that support the Department's preliminary decision to regulate all of Pennsylvania. Every major dairy co-operative located in Pennsylvania and every general farm organization based in Pennsylvania supports the regulatory approach to Pennsylvania put forward in the Department's May 20 proposal, including the Pennsylvania Farm Bureau, the Pennsylvania Grange, and the Council on Northeast Farmer Cooperatives.

Milk processors in Pennsylvania should be competing for supply and customers on the basis of their own abilities, not on the basis of where in the state their plants happen to be located. The Department has noted that the two factors it viewed as the primary factors for determining marketing areas are (1) where handlers compete for sales of fluid milk products, and (2) where handlers compete for milk supplies. [May 20 USDA Revised Preliminary Report at 11-12.] This suggests that a marketing area should include within its borders all handlers that compete against each other for sales and for supplies. That definition of marketing area makes clear that the inclusion of western/central Pennsylvania was correct.

The Department itself decided to include previously unregulated areas as part of its May 20 proposal precisely because it saw this as a way to reduce inequity. In its May 20 proposal, the Department correctly identified the inequities inherent in a polyglot market order system, when it said, "In several cases, handlers who would become regulated . . . are located in areas where they compete with handlers who would not be similarly regulated. Handler equity suggests that these handlers, too, should become regulated." [May 20 USDA Revised Preliminary Report at 3 (emphasis added).] We could not have said better. We could not agree more.

For all of these reasons, MMI strongly urges the Department to stick to its guns and stick with its clearly correct decision to include currently unregulated portions of western/central Pennsylvania in the mideast and northeast marketing areas.

Sincerely,

Milk Marketing, Inc.

By: William R. Perry

William R. Perry, Vice President
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cc: Herman Brubaker, Chairman
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