PR-726

MILK PRODUCERS COUNCIL

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April 15, 1998

Mr. Rich Mc Kee
Director, Dairy Division AMS
United States Department of Agriculture
P.O. Box 96456
Washington D.C. 20090-6456

Re: Comments on the Proposed California Federal Order and the Federal Order Proposed Rule

Dear ~~Mr. McKee~~ Rich:

Milk Producers Council is a dairy farmer trade association with about 200 members located in Southern and Central California. We offer these comments for consideration on two topics; First on the need of the Secretary of Agriculture to positively respond to a petition submitted by our group in association with a number of other California producer groups to promulgate a California Federal Milk Marketing Order for California producer consideration and secondly our comments on the proposed Federal Milk Marketing Order Rule released by USDA on January 23, 1998.

One of the messages that is strongly emerging in the wake of the issuance of the Proposed Rule is that federal order reform is doomed with out the alignment of California manufacturing prices with federal order prices. Milk Producers Council has been on the front lines in trying to get California officials to acknowledge and fix the misalignment that currently exists in these prices between California and the rest of the Country. As is becoming painfully obvious from the comments heard from other parts of the country, if Federal Order Reform is to have any chance of success, California manufacturing prices must come in line with Federal Order prices. We are convinced that California officials will not on their own fix the problem. They have had many opportunities to do so, most recently in the fall of 1997 and have stubbornly refused to make even small steps in a corrective direction. Therefore we as California producers believe that the only realistic chance that exists to bring California prices into line is to actively pursue the establishment of a California Federal Milk Marketing Order. We have petitioned the Secretary of Agriculture to promulgate an order for California producer consideration. We understand that normally USDA waits until you receive overwhelming cooperative support in a region for a federal order, before you put the order out. In this case, a number of California manufacturing cooperatives who enjoy the marketing advantages California's cheap milk policy gives their plants in the national marketplace are opposing USDA putting out an order for producer consideration. We as California producers do not want to be responsible for dragging the rest of the country's price down to our level, nor do we wish to be responsible for the failure of the federal milk order reform effort. We need a chance to take the issue of becoming a California federal order directly to our fellow producers in California. In order to do that USDA needs to show us what a California federal order would look like. Our petition outlines a specific California Federal order modeled on the new proposed rules. We respectfully ask you to proceed.

On the issue of the specific reforms, USDA is to be commended for their outstanding professional work in producing a proposed federal order reform rule that modernizes the system while maintaining its pro-producer emphasis. We do have the following concerns with the proposed rule:

* On class 3 and 4, which are driven off of end product values, we are very concerned about the development of the NASS plant price surveys for butter, cheese, powder and whey. Our concern is based on our experience in California which uses a plant survey price for our class 4a. The problem is that California, in addition to doing a monthly survey for class 4a purposes, also conducts a published weekly average price which has become a pricing index for powder buyers and sellers. We are credibly told that over 90 percent of the volume of powder in that weekly price survey has been sold at a price that is directly indexed to the previous weeks average price. This creates a circular situation where if the market price of powder is moving up reflecting supply and demand conditions, less than 10 percent of the volume in the plant price survey reflects the increase in market value. The index does move up a little bit the next week, but because of the small volume of truly market priced product in the survey it takes weeks for the price to rise and mathematically it is impossible for the survey price to ever reach the top of the market. Furthermore, buyers are not stupid, when the indexed contract price is lower than the market price they take larger volume contract deliveries slowing further the survey's ability (because it is weighted by volume) to catch up to the current market. Conversely, when indexed contract prices are higher than market prices, because the market is falling, buyers reduce the volume of contract purchases and supplement their needs from the current market, causing the index price to fall faster than it rose. This type of system does not reflect the real market value for powder and hurts producers. The only reason we in California have been able to tolerate this situation is that the rest of the country is currently working under the IIIa system which uses a product value "range" which does more accurately reflect the current market value of powder. If the whole nation adopt a product price discovery mechanism similar to the California system, we suspect that prices would almost never move off of their lowest levels because powder makers will have their margins covered by the make allowance and it would be very difficult to move the price up significantly when 90 percent of the product is already indexed priced. The solution to this problem is either to use exchange prices, which in the case of powder and whey do not exist, or exclude from the NASS plant survey all volume

of product, if its sales price is indexed to that same NASS survey. We cannot emphasize enough the importance if USDA is going to move to a product pricing formula of getting the price discovery mechanism right. Whatever USDA establishes as a price discovery mechanism will influence how product is priced. If we get it wrong, it will not self correct and producers will be seriously hurt.

* We expect that there will be some modifications of the make allowances and yields in the class 3 and 4 formulas. We would not strongly oppose the National Milk Producers Federation proposal for cheese and whey. But we do believe that NMPF went too far in raising the butter make allowance and we think USDA was pretty close to accurate their proposed powder yield.

* For class 1, we strongly support Option 1A, and strongly oppose Option 1B. 1B is based on a complicated computer model that has some obvious flaws. For example: Los Angeles County, which has millions of people and no cows has a class 1 differential in 1B of $1.22 per cwt., While San Bernardino County, located 40 miles away has several hundred thousand cows and much fewer people than Los Angeles and has a differential of $1.41 per cwt. This makes no logical sense. We understand that this strange phenomenon exists in the 1B price surface in other parts of the country as well. This indicates that 1B does not have a sound basis and should be rejected. 1A is a flatter and more justifiable price surface than currently exists and we strongly support it.

* We support the concept of using some sort of moving average base price for class 1. We are intrigued by the six month decline average proposed by USDA and could probably support it. We also strongly support the proposed use of the higher of either the class 3 or class 4 solids price as the value in the base price for class 1.

* We support component pricing, but we would like to see it extended to class 1 milk as well. We have had component pricing for class 1 in California for many years and it has worked well. If USDA is truly interested in modernizing the federal order program component pricing is the way to go.

We thank you for the opportunity to comment. If you have any questions please contact Geoffrey Vanden Heuvel at 909-597-1128.

Sincerely,

Bob Feenstra

Robert Feenstra
Executive Director