FOR-2887

CALIFORNIA DAIRY CAMPAIGN

"DAIRYMEN WORKING FOR DAIRYMEN"
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June 6, 1997

Richard M. McKee, Director
United States Department of Agriculture
Agricultural Marketing Service
P.O. Box 96456
Washington, D.C. 20090-6456

Dear Mr. McKee:

The California Dairy Campaign (CDC) is submitting this comment letter to the United States Department of Agriculture in response to the preliminary reports on the Basic Formula Price Alternatives, Class 1 Price Structure Options and Classification. On March 29, 1997, CDC submitted a proposal based on the Dairy Producer's Milk Pricing Plan that had been adjusted to include a Feed Cost Adjustor. We feel this proposal deserves significant consideration by USDA in the reform process.

Before giving comment on the specific proposals, CDC would like to give some view points that we feel are very significant concerning the nation's dairy industry. First is the point of simple business economics: cash flow. It is easy the blame the dairy producers for producing the much milk, however, when a business is in a cash crunch due to low prices the primary solution is to increase output to maintain the same level of cash flow. This scenario is what we see in today's dairy industry. The resulting increase in production basically irritates the supply and demand situation even further causing milk prices to remain lower for a longer length of time. In today's pricing mechanism the producer is placed at a disadvantage, since they are the ones that are fundamentally effected by market risks.

In general, dairy producers today are only looking for a fair and reasonable price for their product. Since milk is a very perishable commodity, which is produced every single day, the nation's dairy producers are at a marketing disadvantage. Normally in business there is an easy on-off switch, as you know, this is not the case with a dairy operation. This scenario makes it very difficult for producers the receive a fair market price.

It is especially true when only end product pricing is the only factor that determines the value of a dairy producers raw milk such as the system that is used in California. It is absolutely ridiculous to discount all the milk on the market because there is one truck load over what is needed. In an ordinary business when a product is sold the established price is determined mainly by input costs. If the product is in demand the price increases to reflect this factor. The opening price, however, is usually established to cover at the minimum the input costs. Today, many dairy producers are requesting this logic be used when USDA is determining milk pricing formulas.

The next point is also one of economics. This would deal with the industry's demise in the number of dairy producers. This dilemma is not only effecting dairy producers families but entire rural communities. The dairy producing industry involves many other business to keep it in operation, such as equipment sales and service, feed, veterinary needs, trucking services, and many more. A USDA report released in late 1996 indicated that from July 1995 to July 1996 dairy farm numbers declined 5.3 percent. Some states this past year have experienced a ten percent decline in the number of producers. This should be cause for major concern because it indicates milk has been extremely undervalued.

Basic Formula Price Options

CDC is advocating the use of the Dairy Producer's Milk Pricing Plan with the use of a feed cost adjustor as suggested by our March 29th request. An adjustor of producer feed costs should allow the increase in feed prices to be passed onto the market as soon as possible, so that producers would have a responsive milk pricing system. A pricing system with an adjustor for producer feed costs would sustain an adequate supply of milk for all uses. This would minimize negative consumer reactions from the spikes of dairy product prices caused by supply volatility.

Here are our comments on the four options that the Committee identified for further discussion.

Option 1 & 2:
CDC supports the concept of multiple component pricing. Both of these options, however, rely heavily on end product prices. End product prices are used as the base from which a make allowance is subtracted.

Option 3:
This option is the least favored. As the report indicates, this option will result in a much lower milk price compared to the track record of the M-W/BFP. A major issue in California's milk pricing system has been the setting of a make allowance level. Make allowances tend to become obsolete rapidly allowing for plant inefficiency and interfere with market signals. This option will gives significant protection from market forces to the plants while placing all the risk on the producing sector.

Option 4:
This option is the most favored of the reported options because includes the competitive factor that has not been mentioned in the other options. This option is similar to the Dairy Producer's Milk Pricing Plan, however, there is a significant difference. The Dairy Producer's Milk Pricing Plan begins with a product market price that is modified by the competitive

factor. This allows for a new month's market price to be established prior to the competitive adjustment.

Class 1 Options

From the options released in the preliminary report, the option that is most in line with our beliefs for Class 1 pricing is Option A1. However, the level of the fixed differential needs to be increased from $1.60 to the $2.00 level in order to consistently attract milk to service the Class 1 market needs. We strongly support the Class 1 pricing mechanism of the Dairy Producer's Milk Pricing Plan, which utilizes the establishment of a Fresh Milk Base Price derived from a 12 month rolling average. It is well understood that the cheese markets and fluid milk markets have unique marketing differences, which justifies usage of a rolling average concept.

Classification Preliminary Report

California Dairy Campaign is in full agreement with the reports recommendation of changing the classification of milk used for nonfat dry milk from Class III-A to Class III, basically eliminating Class III-A. There is concerns of the effects to producer revenue from nonfat dry milk replacing fluid milk usage in Class II and Class III when the Class III-A price is lower than the Class III price.

The California Dairy Campaign greatly appreciates this opportunity to comment on the preliminary reports and the status of the dairy industry.

Respectfully,

George Mertens

George Mertens
President