and half percent above February 1997. And it has been increasing at an increasing rate for several months. These trends have resulted in Class III and IIIA uses in that area increasing tremendously.

Last month the Commission reserved nearly $700,000, about 76 percent of the $914.00 in the Compact pool to pay for the added cost of the Commodity Credit Corporation. This policy makes no sense. It increases costs to consumers, increases milk production and takes the added money to purchase surplus milk created by the higher prices.

When you put all of these initiatives into perspective, it's a lot more regulation not less.

Thank you, sir.

PR-628

MR. POMBO: Thank you. Mr. Tillison.

MR. TILLISON: Thank you, Chairman Pombo. My name is Jim Tillison. I'm Executive Vice President and CEO of the Alliance of Western Milk Producers.

The Alliance represents five major cooperatives which would be qualified entities under a federal order and thus able to block vote on behalf of their 1,200 producer-owners. These organizations along with California Gold Dairy Products with approximately 350 producer-owners has advised USDA that they're not in favor of pursuing a federal order at this time.

Since there are 2,100 qualified producers in the state, we think that this is not insignificant. The reasons for the Alliance members are simple. There are a number of questions to which there are answers we need to get from USDA which are a critical part of evaluating the pros and cons of California joining the federal order system.

For example, quota alone is a $700 million question. Handled improperly through the reform process and California producers could very well loose that investment. We also want to see the final proposal so a thorough evaluation of a possible California federal order can be made.

I'd like to respond to comments often made about the potential impact on the federal order system if California does not join that system. It is obvious that the USDA recognizes the potential impact of a federal order system that the California state order can have. They are proposing a system that is very similar to the California system. Since our product manufacturers and fluid product processors use the same milk under federal orders as well as the California order, it makes sense that the value of all uses of milk be based on the hard products that are made from that milk.

Regarding the impact of California staying out of the federal orders, on the federal orders, I have to

disagree with the doomsayers claim that unless California joins the federal order system, it will be the end of both systems.

With the proposed reform efforts, the similarities of the two systems makes it much easier for each to adapt to the other. This was not possible when the method of determining the value of milk that went into manufactured products was so very different. With reform both systems would price milk used to manufacture products based off hard product values. With reform both systems would use manufacturing costs, commonly called make allowances, in the amount of cheese, butter and non-fat dry milk powder a hundred pounds of milk will yield to calculate milk prices.

Because of the similarity of the two systems, whether or not California joins the federal orders becomes much less important to long-term survival of the federal order system. California cooperatives and manufacturers realize that our system will have to adjust to the reformed federal system. I'm confident that California producers will not allow a large discrepancy in the value of California milk used to manufacture products compared to the federal system to continue.

I only need to point to a hearing we had last year in which our Class I prices were lowered by 60 cents a hundred weight so that they would be in line with Class I

prices in surrounding areas. Why hasn't California made adjustments to its manufacturing milk prices before this? In addition to the reason of the dramatic dissimilarity of the two systems discussed previously, there are a number of other reasons.

First, Section 102 of the 1990 Farm Bill was passed. And because of the controversy this ill-advised move caused, California made no adjustments in its make allowances until Section 102 was done away with in the '96 Farm Bill.

Prior to Section 102, our make allowances were being adjusted downward on practically an annual basis. In addition, the adjustments required by the Farm Bill, the cheese make allowance was lowered through the California hearing process just this last October.

Other reasons -- change in the California system toward the federal system hasn't occurred include the reform of the basic formula price which took from 1995, to until 1995 and now federal order reform. When the final federal reform proposal is put forth later this year, California will finally have a long-term federal pricing system it can evaluate its milk pricing system against and adjust as may be necessary. Unfortunately, the restriction on being able to maintain our quota system in the '96 Farm Bill makes a positive vote in California very unlikely.

PR-628A

The Alliance

of Western Milk Producers

House Dairy Subcommittee Hearing on Federal Order Reform

A Statement on Behalf of the Alliance of Western Milk Producers

James Tillison, Executive Vice President/CEO

March 26, 1998

1225 H Street, Suite 102, Sacramento, CA 95814
Phone: (916) 447-9941 Fax: (916) 447-9942

The Alliance of Western Milk Producers represents five major California cooperatives that would be qualified entities under a federal order and thus able to bloc vote on behalf of their approximately 1200 producer-owners. These organizations, along with California Gold Dairy Products with approximately 350 producer-owners, have advised USDA that they are not interested in pursuing a federal order at this time. We understand Western United Dairymen, California's largest producer trade association, has submitted a written statement to this committee indicating that is its position as well.

The Alliance members' reasons for this position are simple. There are a number of questions to which answers are needed from USDA in order to evaluate the pros and cons of California's decision to join the federal order system. We also want to see the final proposal so that a thorough evaluation of a possible California federal order can be made. With the questions answered and a final rule in hand, a thorough analysis of the financial impact on individual California producers' investments in their dairies, quota and their cooperatives can be made.

Rather than spend time speculating on whether California producers will become part of the federal order system or remain a state marketing order, I would like to respond to comments often made about the potential impact on the federal order system if California does or does not join that system.

It is obvious that the USDA recognizes the potential impact on the federal order system the California state order can have. The proposed federal system is a dramatic shift away from the current Upper-Midwest-competitive-price-based system. The proposed system uses the market value of manufactured products made from milk as the basis for establishing milk prices.

The proposed federal system is very similar to the California system. Since hard product manufacturers and fluid product processors use the same milk under federal orders, it makes total sense that the value of all uses of milk be based on the hard products made from that milk.

Regarding the impact California would have on the federal orders if California retains its state order, I have to disagree with the doomsayers' claim that unless California joins the federal order system, it will be the end of both systems.

Let us not forget that the California system has been a product-based system for a very long time. The difference is that the California system has continued to evolve over the last forty years, while, by comparison, the federal order system has not.

With the proposed reforms, the federal system catches up. The similarity of the two systems makes it easier for them to adapt to each other. This was not possible when the method of determining the value of milk going into manufactured products was so very different -- an Upper-Midwest-competitive-pay-price versus a cheese milk value based on the market value of cheese. With reform, both systems would price milk used to manufacture products based off hard product values.

With reform, both systems would use manufacturing costs (commonly called make allowances) and the amount of cheese, butter or nonfat dry milk powder a hundred pounds of milk will yield to calculate milk prices.

Because of the similarity of the two systems, whether or not California joins the federal order system becomes much less important to the long-term survival of the federal order system.

Why do I say that? Because I think the two systems must and will move toward each other. The Alliance has had discussions with the National Milk Producers Federation regarding its proposal which moves the federal proposal toward the California system. California cooperatives and manufacturers realize that our system will have to adjust to the reformed federal system as well. I am confident that California producers will not allow the continuation of a large discrepancy in the value of California milk used in manufactured products compared to the same milk in federal orders.

Some might ask why California hasn't made adjustments to its manufacturing milk prices before this? In addition to the dramatic dissimilarity in the two systems discussed previously, there are a number of other reasons.

First, if you look at the history of California's make allowances, you will see that after being increased in the early and mid-eighties, the California Department of Food and Agriculture, through the hearing process, had begun adjusting the allowances downward in the late eighties. Then, Section 102 of the 1990 Farm Bill was passed and because of the controversy this ill-advised move caused, no adjustments were made in California to make allowances until Section 102 was repealed in the 1996 Farm Bill.

In addition to the adjustments required by the Farm Bill, the cheese make allowance was lowered through the California hearing process last October.

The other reasons that change in the California system toward the federal system hasn't occurred include reform of the Basic Formula Price (BFP) which took from 1992 until 1995 and, now, federal order reform. It made little sense for California to adjust its value of milk used in manufacturing while it was uncertain what the federal order value for the BFP would be. Then, even when it was revised, we were told it was a temporary fix.

By then, the 1995 farm bill debate had also begun and it was evident that more changes were on the way in how the federal orders priced milk used to manufacture products.

When the final federal order reform proposal is put forth later this year, California will finally have a long term federal order pricing system against which it can evaluate its milk pricing system and adjust as may be necessary.

What will it mean to the federal order system should California producers decide to join it? I don't think it will mean much more than if California remains a state order. For example, producers outside of California currently have the opportunity to sell their milk to manufacturers in California. Under a federal order, the price they must be paid for their milk would be specified; this is not currently done.

The other thing that it would mean is the federal order system could say it regulates 90 percent of the milk in the United States instead of 70 percent.

The key point I want to get across is that California does not have to become part of the federal order system. When reform is complete, the systems will be similar enough that California will adjust to the federal system regardless.

In closing, I would like to praise USDA for "pushing the envelope", for resisting staying with the status quo, and challenging the industry to seriously consider a new way of pricing milk. The proposed system is much more market driven than the old system because all the prices of the various classes of milk are based on dairy product prices that manufacturers are actually receiving for their milk.

The Alliance will be submitting comments and suggestions to USDA on adjusting the product values, make allowance and yield levels used in the new system that will facilitate the two systems working in sync if that is what California producers choose.

Finally, I would urge the members of Congress to resist calls for legislative action to change the final program USDA puts forward and on which producers vote. From the meetings I have attended and from what I have heard, the majority of the dairy industry, producer and processor alike, are generally supportive of the system USDA has proposed. That's not to say that there is general agreement on what numbers should be used in the system, but it is to say that the system itself is generally supported.

Respectfully submitted,

James E. Tillison
Executive Vice President/CEO