TESTIMONY
of
William Schiek
on behalf of

EXHIBIT
46

Dairy Institute of California

at the
Consolidated Stabilization and Marketing Plan Hearing

Sacramento, California
May 3, 2005
8:30 a.m.

Mr. Hearing Officer and members of the Hearing Panel:

My name is William Schiek. I am Economist for Dairy Institute of California and I am testifying on the Institute's behalf. Dairy Institute is a trade association representing 40 dairy companies which process approximately 75% of the fluid milk, cultured, and frozen dairy products, over 60% of the cheese products, and a small percentage of the butter and nonfat milk powder processed and manufactured in the state. Member firms operate in both marketing areas in the state. The position presented at this hearing was adopted unanimously by Dairy Institute's Board of Directors.

Dairy Institute appreciates the opportunity to testify at this hearing in support of our petition to adjust California's formula for setting Class 1 prices. We also thank the Department for the opportunity to comment on the proposals by the Alliance of Western Milk Producers, Western United Dairymen, and the California Dairy Campaign, which are also under consideration at this hearing.

At issue in this hearing are proposed changes to the pricing formulas for Class 1. In establishing pricing formulas, the Secretary is directed by the legislature to weigh the factors found within statute. The California Legislature has declared that milk production and marketing is a business affected with a public interest (Sec. 61801). Therefore, the dairy programs must be operated so that the public interest is served. The public interest extends well beyond consideration of producer interests exclusively, and also includes the interests of processors, retailers, distributors and consumers. The legislature states also that it is the policy of the state to promote, foster, and encourage the intelligent production and orderly marketing of market milk and to eliminate economic waste, destructive trade practices, and improper accounting for market milk (Sec. 61802(e)).

The legislature has declared that the prices established by CDFA must allow for prices to producers and consumers that are fair and reasonable (Sec. 61802 (h) and Sec 62062(b)). In addition, the Secretary must consider how the pricing formulas provide for uniform milk prices to handlers operating within the marketing areas (Sec. 61805 (b)). Also, the combined producer revenue from all milk classes must be sufficient so as to result in an adequate supply of milk for

all purposes (including manufacturing purposes) which is vital to the public health and welfare (Sec. 61802(a)-(d)) and Sec. 62062 (b)).

With regard to class prices, the legislature requires that the Secretary consider milk production costs in setting such prices (Section 62062(a)). The Secretary has been directed by the legislature to ensure that Class 1 prices are in reasonable relationship to Class 1 prices in surrounding states (Sec. 62062.1), ***and that the prices for market milk bear a reasonable and sound economic relationship to each other (Sec 62062 (c)).*** The Secretary is also directed to conform the pricing standards governing minimum producer prices for market milk to current economic conditions (Sec. 61802(g)) and to consider any other relevant economic factors in setting milk prices that are not explicitly set forth in the Code (Section 62062).

The Secretary must consider how to set prices and pricing formulas such that **all** of the declared intentions of the legislature are met as closely as possible. In so doing, the Department must look beyond the confines of any single Section of the Code. When all relevant economic factors are considered in tandem with the specific legislative directives regarding milk pricing, it is evident that the current Stabilization and Marketing Plans for market milk no longer provide for Class 1 prices that conform with these directives; and therefore, the plans must be changed. Specifically, Class 1 prices generated by the current formulas fail to meet each of the statutory criteria in the manner listed below.

I. The prices for the various classes of milk no longer bear an economically sound and reasonable relationship to each other.
II. The current Plans have created a combined income that is more than necessary to insure an adequate and continuous supply of milk for all purposes.
III. The current Class 1 pricing formulas employed in the Plans do not conform pricing standards to current economic conditions.
IV. The current Stabilization and Marketing Plans result in prices to consumers of fluid milk products that are not fair or reasonable.
V. Current Class 1 prices are not in a reasonable relationship to prices in surrounding states.
VI. The current Plans fail to achieve uniformity of raw product costs to processors competing in a marketing area, even though it is the directive of the legislature that the Secretary endeavor to do so.
VII. The current Plans fail to promote, foster, and encourage orderly marketing and they encourage, rather than discourage, economically wasteful and inefficient milk marketing practices.

Dairy Institute's Proposal

Each of the forgoing failures of the existing stabilization and marketing plans will be examined and explained in greater detail, but they all stem from the fact that Class 1 prices are too high relative to the manufacturing classes of milk in the state. Dairy Institute's proposal would reduce Class 1 prices in both Northern and Southern California, and in so doing would bring the current

plans more in line with the requirements and guidelines set forth by the legislature. Our proposal is relatively straight-forward.

Dairy Institute proposes that the Commodity Reference Price (CRP) adjuster employed in the calculation of the Class 1 solids not fat and fluid carrier prices be changed from its current value of +$0.464 per hundredweight to a new value of - $0.416 per hundredweight. These changes should be made to both the Northern (Plan 44) and Southern (Plan 59) California Stabilization and Marketing Plans. This change amounts to an 88 cent per hundredweight reduction in the Class 1 price, and given the current Class 1 utilization in the pool (@ 15%) would result in a reduction to producer pool prices of about 13.2 cents per hundredweight. The following sections of our testimony will explain how the parameters of the proposed changes were derived and will explain in greater detail why reductions in the Class 1 price levels are absolutely essential for the continued health of the California dairy industry.

I. The Class 1 Price Relationship With Manufacturing Class Prices Is Not Economically Sound Or Reasonable.

The spread between Class 1 and manufacturing class prices is too large, meaning that the prices for the various classes of milk are not in a reasonable and sound economic relationship to each other because of:

a. Reductions in Class 1 utilization
b. Low California milk production costs in relation to other areas
c. Too much Class 1 price enhancement on top of the traditional the cost-based justifications for Class 1 price differentials.

The most commonly used descriptor of the relationship between manufacturing milk class prices and Class 1 prices is the Class 1 differential. The Class 1 differential is calculated as the Class 1 price less the higher of the Class 4a or 4b price when such prices are calculated using the same sets of commodity values. Using the commodity prices employed in Class 1 pricing calculations from April 2000 through May 2005, the calculated Class 1 differential averaged $2.09 per hundredweight for Northern California and $2.36 in Southern California. The calculated differential we describe here should not be confused with the imputed California federal order differential, which is equal to the California Class 1 price less the federal order Class 1 price mover. This imputed differential compares California Class 1 prices to federal order manufacturing class prices and it had been used to determine changes in the relationship between California and Federal order Class 1 prices; however, it is of little relevance when attempting to determine the relationship between fluid and manufacturing class prices within California.

Class 1 Utilization Reductions

The class 1 utilization percentage in California has fallen well below that in all other markets, yet the price spread between fluid and manufacturing use prices is as large as markets that have significantly higher Class 1 utilization percentages. The attached table (Table 1) summarizes the average Class 1 utilization in 2000-2004 and a five-year simple average for California and the

Federal Order markets. California's long-term trend has been for decreasing beverage milk utilization as milk production growth has rapidly outpaced usage of fluid milk products (Figure 1).

Table 1. Class 1 Utilization in California and Federal Order Markets

Market	2000	2001	2002	2003	2004	Average 2000-04
			Percent			
California	***20.0***	***19.0***	***18.0***	***18.0***	***16.0***	***18.2***
Northeast	43.9	43.3	42.2	44.5	47.2	44.2
Appalachain	68.8	65.2	66.3	70.4	69.7	68.1
Southeast	65.0	61.9	60.1	65.5	64.8	63.4
Florida	88.1	89.9	88.9	85.2	84.9	87.4
Mideast	47.4	38.5	36.9	41.6	40.7	41.0
Upper Midwest	17.5	19.8	20.2	24.3	25.8	21.5
Central	30.4	27.4	26.0	32.8	37.5	30.8
Southwest	45.6	46.8	41.8	44.4	47.1	45.1
Arizona-Las Vegas	31.3	32.2	31.9	31.9	33.4	32.1
Western	25.1	22.1	19.7	24.3	26.1	23.4
Pacific Northwest	31.0	29.6	27.0	33.2	33.0	30.8
Average All Federal Markets	39.3	38.2	36.7	41.5	43.6	39.8

Source: USDA Federal Milk Market Order Statistics, CDFA Dairy Hearing Background Resource.

California's Cost of Production

California's cost of producing milk is among the very lowest in the nation, and when combined with the state's low Class 1 utilization requires that the state's Class 1 differential should be lower than what is seen in all other marketing areas. Due consideration of California's cost of milk production suggests that lower Class 1 prices are warranted. Table 2 is a comparison of costs of production, fluid utilizations, and Class 1 differentials in various markets. As can be seen in both the raw data and the ordinal rankings, no other market has the combination of low utilization and low cost of production, and yet is characterized by a high Class 1 differential. This comparison suggests that California Class 1 prices are too high relative to manufacturing prices, given the current market conditions and structure that exist today.

Figure 1. California Milk Production and Beverage Milk Utilization, 1980-2004

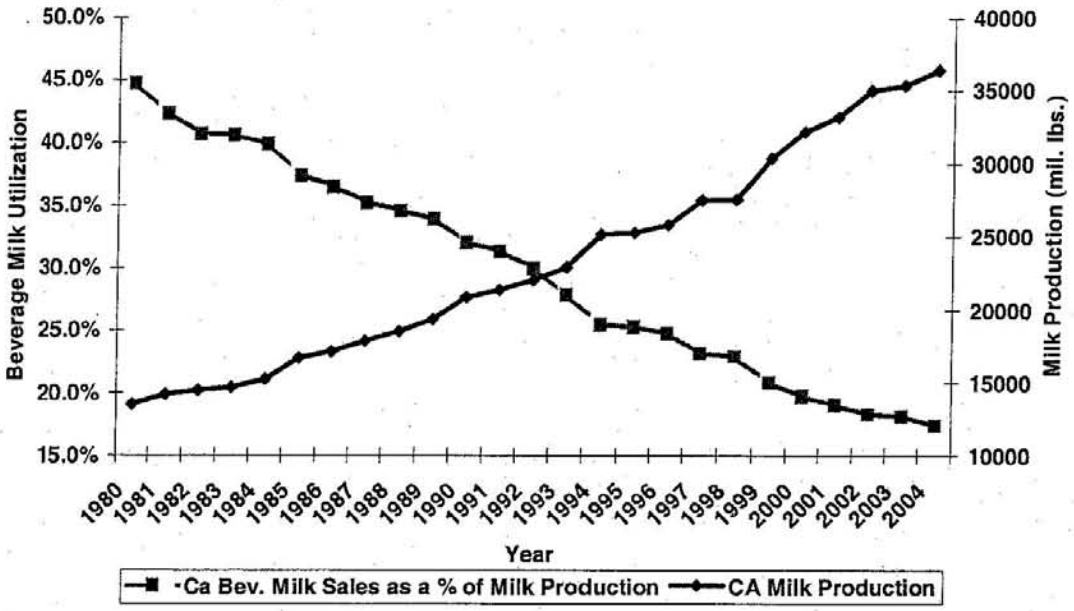


Table 2. Class 1 Utilization, Class 1 Differentials and Milk Production Costs, Various Markets

Market	Class 1 Differential 1/	Class 1 % Utilization	USDA 2003 Cost of Production 2/	Genske Mulder Production Costs 3/
	$/cwt.	%	$/cwt.	$/cwt.
Northeast	3.25	44.2	19.58	
Appalachain	3.10	68.1	21.97	
Southeast	3.10	63.4	18.76	
Florida	4.00	87.4		
Mideast	2.00	41.0	21.66	
Upper Midwest	1.80	21.5	20.10	
Central	2.00	30.8	20.32	14.16
Southwest	3.00	45.1	13.52	12.50
Arizona-Las Vegas	2.35	32.1		13.01
Western	1.90	23.4	16.94	12.00
Pacific Northwest	1.90	30.8		11.96
California	2.36	18.2	14.53	11.84

Table 2. continued.

Ordinal Rankings of Regions by Category Lowest To Highest

Market	Class 1 Differential 1/	Class 1 % Utilization	Combined Class 1 % + USDA 2003 Cost of Production 2/	Combined Class 1 % + Genske-Mulder Production Costs 3/	
Northeast	11	8	6		
Appalachain	9	11	9		
Southeast	9	10	7		
Florida	12	12			
Mideast	4	7	8		
Upper Midwest	1	2	3		
Central	4	4	5		4
Southwest	8	9	4		6
Arizona-Las Vegas	6	6			5
Western	2	3	2		2
Pacific Northwest	2	4			2
California	7	1	1		1

1/ Class 1 Differential at the Principle Pricing Point for the Federal Order, So. Cal. for California (Attachment 1).
2/ Average for Jan-July 2003. See Jesse and Cropp. For each federal order, the lowest cost state in the region was used as the representative cost (Attachment 2).
3/ As reported in Hoard's Dairyman, March 25 2005. Cost data are averaged for 2000-2004 (Attachment 3).

Too Much Class 1 Price Enhancement

The agricultural marketing literature has a rich discussion as to the reasons for the existence of a Class 1 differential in regulated dairy programs (Babb et al., McDowell et. Al., Schiek). Class 1 prices are higher than manufacturing class prices both because of cost related reasons (higher cost of serving the Class 1 market) and because of policy goals designed to enhance producer income. Specifically, the Class 1 differential is supposed to be sufficiently large to cover:

a. The cost of converting Grade B milk to Grade A milk and maintaining a Grade A milk supply
b. The cost of drawing milk to deficit markets for fluid uses
c. Price/Income enhancement for producers so that the supply of milk is adequate for stated uses.

Grade A Conversion and Maintenance Costs

The most recent public estimate of the extra production costs associated with Grade A status is 15 cents per hundredweight (see Attachment 4, 1990 Federal Order hearing Testimony of Paul Christ). Given California's 2004 average Class 1 utilization of 15.7 percent, it would be necessary to set Class 1 prices about 94 cents (15 cents/0.157) per hundredweight higher than manufacturing milk prices to provide a blended Grade A incentive of 15 cents per hundredweight. This estimate was based on the cost of converting farms in the Midwest to Grade A status from Grade B. The fixed costs of conversion were being spread over a relatively small milk production, yielding a higher cost per hundredweight than would be expected with California dairies. The accompanying tables (Table 3 and Table 4) summarize data obtained from Dairy Institute members regarding the added costs of complying with Grade A requirements in Northern California (as opposed to Grade B requirements). Estimates on the cost of additional facilities and inspection were obtained based on milk inspector and dairy contractor information. These costs could no doubt be easily verified by CDFA staff.

Table 3. Grade A vs. Grade B Facility & Operational Cost Difference Estimates Based on a 750 cow facility in the Northern California.

All Grade A facilities must comply with Article 22. Permanent Market Milk Dairy Buildings of the State of California Code of Regulations

REQUIRED FACILITIES DESCRIPTION	COST ($)
Surroundings, Corrals and Ramps	
Paved lanes within 50 feet of the milk house (12 X 10 = 120 sq.ft.)	1,200
Paved ramp into milk parlor and cow wash area (45 X16= 720 sq.ft.)	7,200
Paved access to permanent feed racks and water troughs (750 X 10 = 7,500)	75,000
Milk House & Parlor	
Milk Parlor Concrete Floors with 4.5 rebar (16 X 16ft. @ $35/sqft.)	2,240
Milk House Concrete Floor (@ $10/sqft)	2,400
Block Wall Construction (8ft high @ $14/sqft.)	10,080
Plastered Wall and Ceiling (@ $5/sqft.)	4,400
Milk House Doors & Window	3,000
Milk House & Parlor Trusses and Roofing (@ $12/sqft.)	4,608
Outside Milk Tank Pad (@ $5/sqft.)	960
Milk Cooling Sytem (2-120 gal water heaters @ $700)	1,400
Temperature Recording System	400
TOTAL Facility Costs	112,888
Annual Inspection Costs:	
Average Difference in Annual Inspection Fees	1,012.61
TOTAL	113,901

Improvement needs will be based on the individual facility.
Not all facilities will need all improvements. The improvements listed include the most common improvements needed to change Grade status.

Table 4. Per Hundredweight Grade A vs. Grade B Facility & Operational Cost Difference Estimates Based on a 750 cow facility.

Herd Size	750
Avg. CA Prod Per Cow (lbs./yr.)	21,139
Total CWT Production	158,543
Total Facility Costs	$112,880
Monthly Payment (10 years at 8%)	$1,369.64
Annual Cost of Facilities	$16,435.68
Annual Cost of Facilities ($/cwt.)	**$0.1037**
Annual Cost of Inspection ($)	$1,012.61
Annual Cost of Inspection ($/CWT)	**$0.0064**
Total Costs (conversion and inspection)	$17,448.29
Total Costs ($/CWT)	**$0.1101**

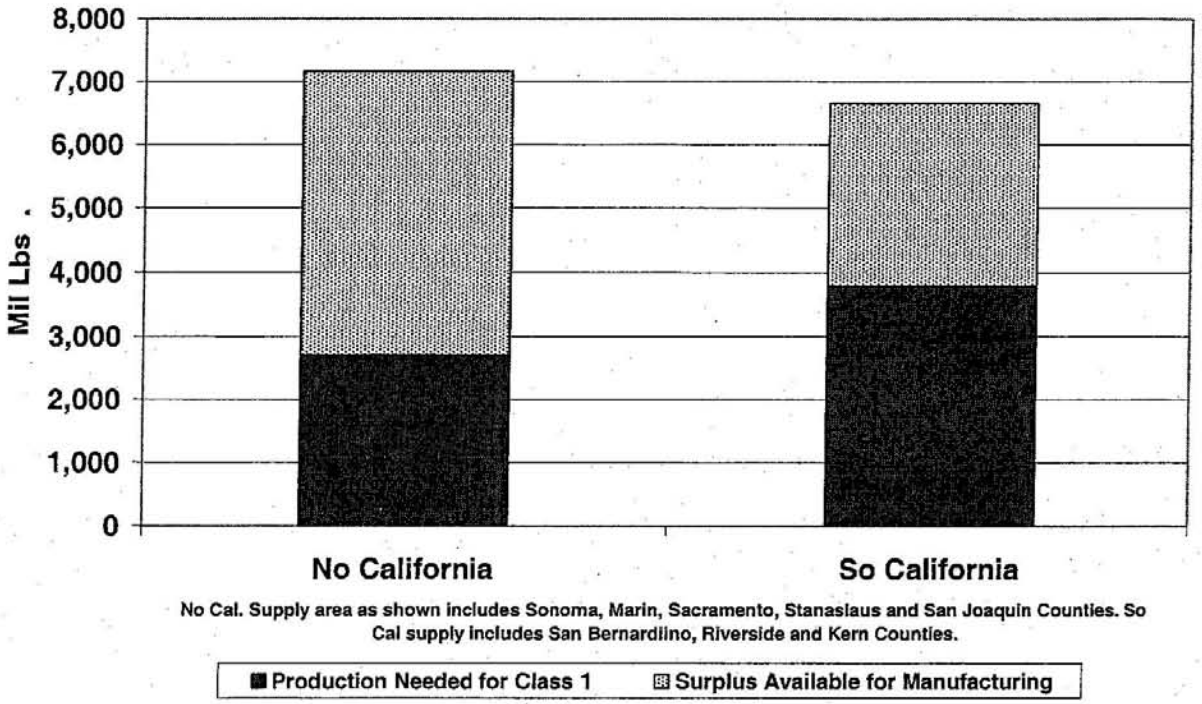
As one can see from the tables, the total cost of Grade B to Grade A conversion is about 11 cents per hundredweight in California, an amount that is significantly lower than the estimate for Grade A conversion cost in the Upper Midwest. An 11-cent conversion cost would translate into a 70-cent Class 1 differential using the methodology we employed earlier. Hence, our proposal of 94 cents per hundredweight for this component of the Class 1 differential already has at least 24 cents per hundredweight of price enhancement in addition to the California cost of Grade A conversion.

Given that Grade A milk currently accounts for over 98 percent of the milk produced in the state, it is questionable as to whether there continues to be a need for an incentive for producers to convert to Grade A status. With 98% Grade A milk in the state, we obviously have far more than we need for the Class 1 and mandatory Class 2 uses, as the combined utilization of Classes 1, 2, and 3 is only 24.3%. The relevant issue here is not one of converting but rather of providing sufficient funds for farms to maintain Grade A status. As can be seen in Table 4, the ongoing cost of maintaining Grade A status is captured by the increased annual inspection fees. These costs averaged 0.64 cents per hundredweight. This cost would translate into a differential for the Grade A maintenance cost of *4 cents per hundredweight.* Clearly, our proposal of 94 cents per hundredweight to cover the added cost of Grade A status is an outside number that contains a substantial amount (90 cents/cwt.) of revenue enhancement for producers.

Drawing Milk to Deficit Markets

Both Northern and Southern California use transportation allowances to incentivize ranch to plant shipments of bulk milk form nearby supply areas to the deficit fluid markets. In Northern California, sufficient supplies are available within approximately 100 miles of Bay Area Plants. In Southern California, sufficient supplies are available within about 170 miles (Figure 2).

Figure 2. Both Northern and Southern California Have Significant Surplus Milk Production in Excess of Class 1 Needs



In Northern California, sufficient supplies are available in Sonoma-Marin and the Northern San Joaquin valley to meet the Bay Area's Class 1 needs. The incentive needed to draw milk to Class 1 plants is equal to the cost difference between the local haul and the haul to the deficit Class 1 plant. For the Northern San Joaquin to Bay Area haul, the needed incentive is about $0.22/cwt. (long haul of 49.3 cents less local haul of 27.2 cents CDFA Hearing Exhibit 8a (HE-8a)).

Southern California is the most deficit region of the state with respect to available milk supplies. Milk supplies in Kern County, combined with existing Southern California milk supplies, are adequate to provide for the region's Class 1 needs plus a reserve. The incentive needed to move milk from Kern County to Southern California can be obtained from the most recent Departmental survey of ranch to plant hauling costs (April 2004) is 48 cents, an amount derived from the cost of hauling from Kern county to Los Angeles (73 cents per cwt.) less a local haul cost of 25 cents per hundredweight (HE-8a). While some will no doubt argue that hauling costs have increased over the past year, it should be noted that in California, Class 1 differentials do not directly incentivize ranch to plant milk movements as is the case in Federal Orders; rather, they are a mechanism to fund transportation allowances, which are paid only the quantity of milk that needs to be moved that distance.

Since not all of Southern California's milk is being supplied from Kern county (there is still a good deal of milk that is much closer, located in the Chino basin), a 48 cent differential would not be needed on all Class on milk in order to provide sufficient funds to pay the necessary

transportation allowances. Based on CDFA milk movement data (HE-2)about 65% of Southern California's Class 1 pool needs are being supplied by milk being shipped from Northern California (March 2004-February 2005 average monthly shipment of 150.5 million pounds divided by the Southern California monthly average Class 1 use of 232 million pounds over the same period.). Therefore, the amount of money necessary to fund these milk shipments could be obtained from a Class 1 differential of about 33 cents per hundredweight ($0.48 per cwt./0.65). As in the case with or Grade A cost calculation, the 48-cent portion of the differential for incentivizing the movement of milk to Class 1 uses is again a generous estimate, which would provide pure price enhancement to producers amounting to an additional 15 cents ($0.48 - $0.33) per hundredweight.

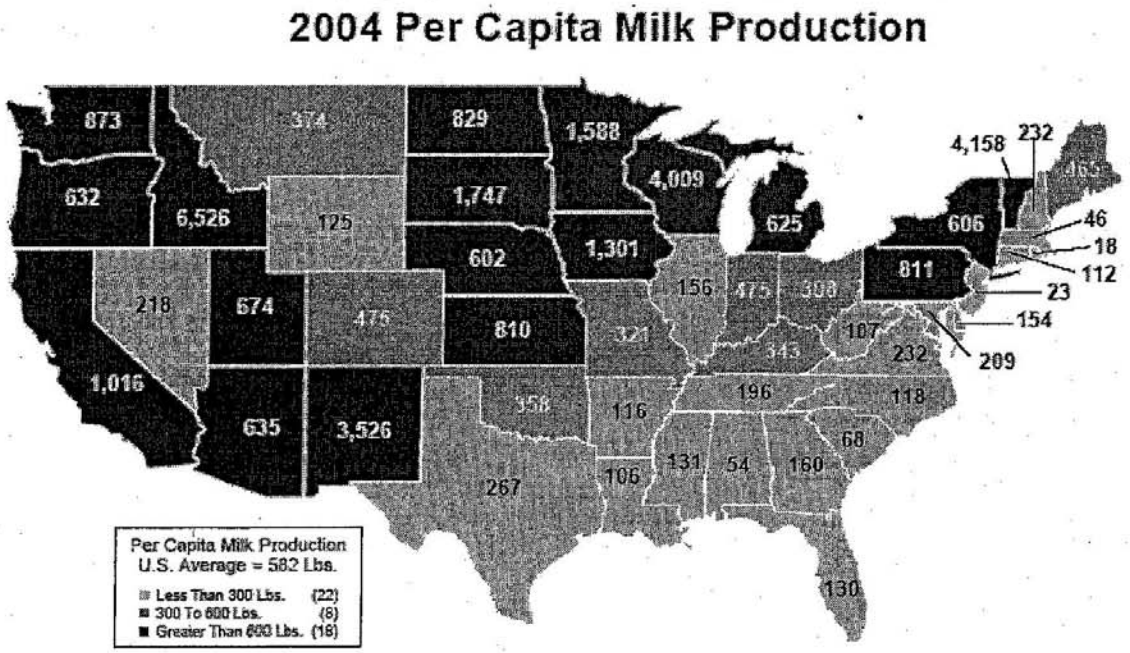
Based on the foregoing, the appropriate Class 1 differential for Southern California is certainly no higher than $1.42 per hundredweight (94 cents per hundredweight plus 48 cents per hundredweight), since our estimates of both the Grade A costs and the milk movement costs show that the differential components we have used more than cover the actual costs they represent. The proposed change in the Class 1 formula contained in Dairy Institute's petition results in a Southern California Class 1 price differential that averages $1.42 per hundredweight based on January 2000 through December 2004 price data, which showed that the average Class 1 differential in Southern California was $2.30 per hundredweight. A reduction in the Class 1 price of 88 cents per hundredweight would achieve the new Class 1 differential level. While the Class 1 price differential needed to cover Grade A conversion and the cost of milk movement in Northern California would be less, we are proposing to base the price differential on Southern California's needs, since it is the largest deficit market in the state. We also advocate maintaining the current area differential of 27 cents per hundredweight between Northern and Southern California.

II. Producer Income Is More Than Sufficient To Generate And Adequate Supply Of Milk.

The supply standard set forth by the legislature is that the combined revenue form all classes be sufficient to result in an adequate supply of milk for all uses, including manufacturing uses. Given current market conditions, it appears that this standard has been exceeded. One measure that has been used to determine if milk supplies are sufficient to cover local needs it the concept of per capita milk production. When a state's per capita milk production exceeds the national average, the state is said to be in surplus with regard to milk supply. California fits the suplus description with a per capita production that is 434 pounds per person per year greater than what is needed to meet the state's dairy product demand (Figure 3.)

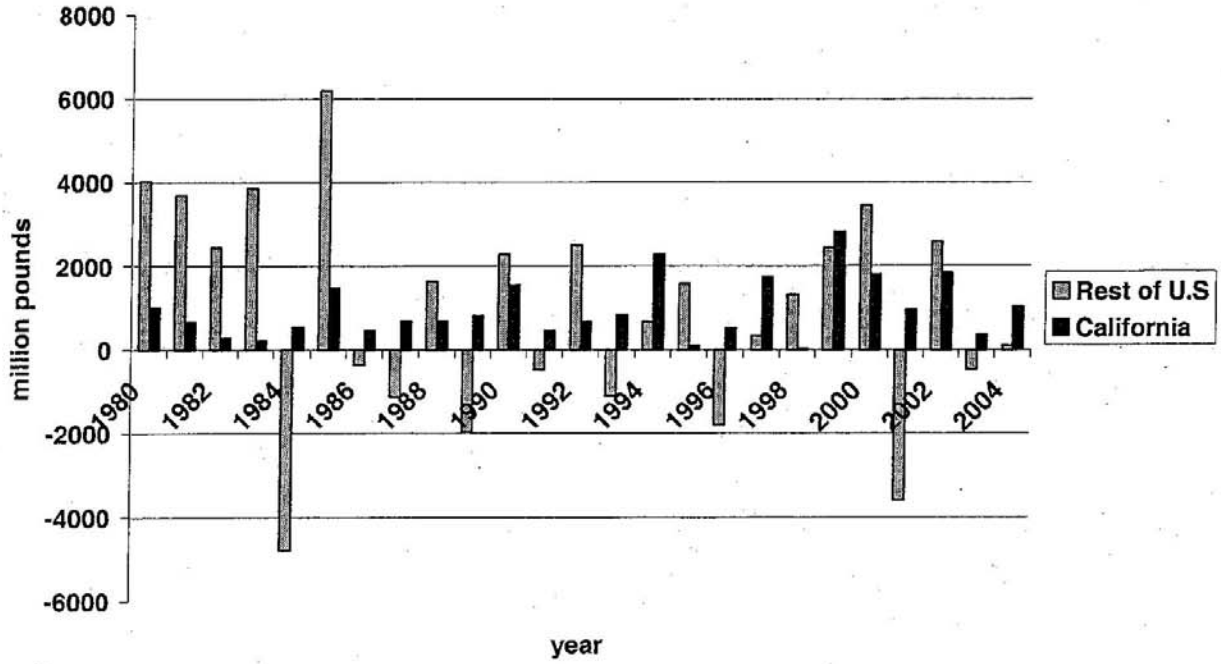
The production of milk in California has continued to increase at a rapid pace. In spite of occasional slowdowns in the rate of production expansion, average annual milk production growth has average 4.4 percent per year since 1990. Since January 1, 2000, the annual milk production growth had averaged 3.7 percent. During the past 25 years, California has accounted for an increasingly larger share of the nation's annual milk production increases (Figure 4). California production increases since 1994 have totaled 13.5 billion pounds, compared to increases of 6.6 billion pounds for the rest of the country.

Figure 3. Per Capital Milk Production By State, 2004



Source: USDA, Federal Milk Market Administrator's Office, Central Milk Marketing Order.

Figure 4. Change in Milk Production from Prior Year, California and Rest of the U.S., 1980-2004



Milk output growth of this magnitude has surpassed what is needed to "insure an adequate and continuous supply..." as required by Section 62062 (b). If milk production continues to grow at current trend rates, the supply of milk will exceed the capacity of the state's dairy product plants in the near future, possibly as early as 2006. To bring the current Stabilization and Marketing Plans under compliance with this section, Class 1 prices must be reduced.

III. Pricing Standards Do Not Conform To Current Economic Conditions.

Current Class 1 prices result in price enhancement that is not in the public interest. The low Class 1 utilization we have today means that for every $1.00 per hundredweight enhancement in the Class 1 price, producers receive only $0.15 per hundredweight. Because low Class 1 utilization requires extremely large enhancements in Class 1 prices in order to make a significant impact on producer income, it is not a very efficient means of meeting producer income requirements. Also, the price discrimination model is predicated on the assumptions of differing elasticities among the various milk classes. The closer the elasticities of the different classes are to each other, the less effective price discrimination is at enhancing producer income.

The textbook model of discrimination assumes an inelastic demand for fluid milk and an elastic demand for manufacturing milk. What we really have in the dairy industry is demand elasticities that are inelastic for most of the major dairy products. There has been some recent academic work by Oral Capps at Texas A&M that has suggested that fluid milk elasticities have become more elastic than they used to be. Likewise, there is some evidence that milk for cheese is more inelastic than previously thought. Recent work by Harry Kaiser at Cornell University suggests that the elasticity for fluid milk is -0.12, while the elasticity for cheese is -0.27. Since wholesale demands for Class I/1 and Class III/Class 4b milk are derived from these finished product demands, the elasticity differences at the wholesale level are likely quite narrow as well. Even if the fluid milk consumption response to price is still more inelastic than for cheese, the difference between the two is relatively narrow and therefore, the efficiency of price discrimination in enhancing producer income is less than what many would assume.

A classic agricultural marketing text (Agricultural Prices, 2nd Ed. by W.G. Tomek and K.L. Robinson of Cornell University, pp. 108-09) puts it this way: "Even if separate markets can be established, gains will be small or nonexistent unless elasticities differ significantly in the separate markets and a relatively large fraction of the total output is sold in the higher priced market." It would appear that neither of these conditions for effective price discrimination is applicable to the Class 1 market in California. In short, our proposed decrease in the Class 1 differential is warranted because the current system of high differentials burdens consumers more than it helps producers.

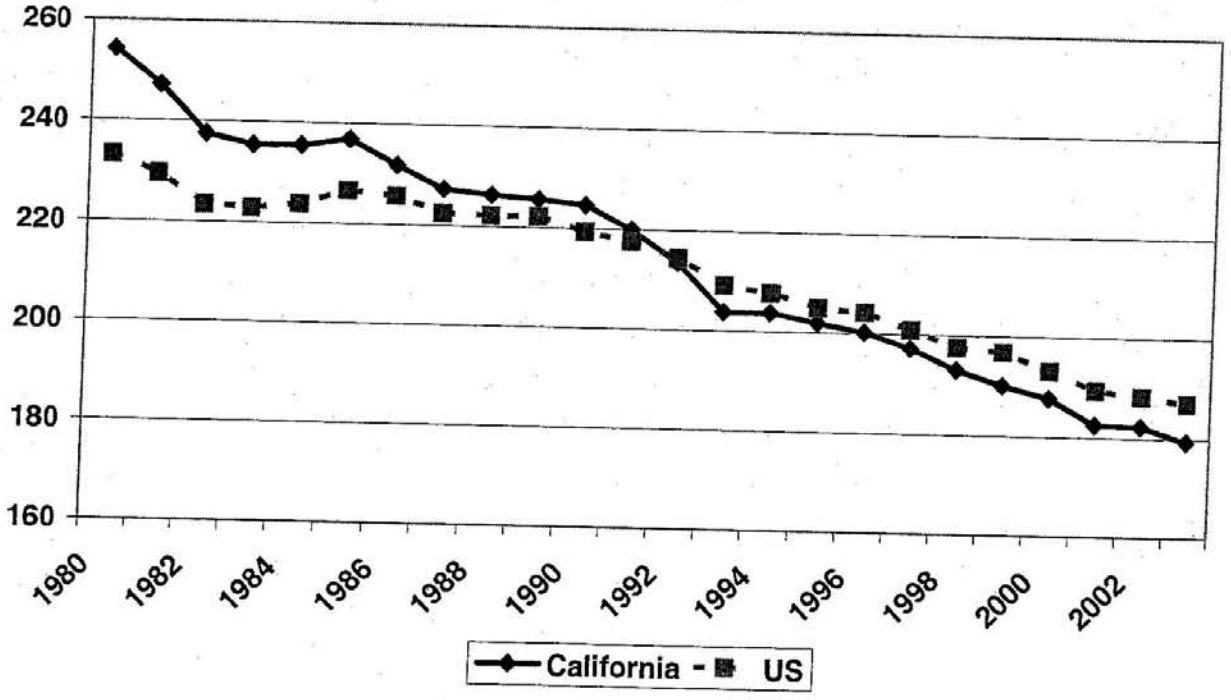
IV. Prices To Consumers Are Not Fair And Reasonable .

The current stabilization and marketing plans result in prices to consumers of fluid milk products that are not fair or reasonable. High Class 1 differentials in California put a heavy burden on Class 1 consumers for supporting producer income. Given the legislature's directive concerning milk supply (an adequate supply for all uses), producer income needs should be borne more

equally among all the milk classes, since consumers of all milk product types benefit from the adequate supply that is generated by the combined income from milk sales to the various uses. California fluid milk consumers are bearing too much of the burden for supporting producer income. Despite California's low Class 1 utilization percentage and the state's stagnant Class 1 usage overall, the price charged to Class 1 milk users in California has not declined relative to the price charged manufacturing milk users.

One of the results of artificially high Class 1 prices, relative to manufacturing uses, has been continued erosion of per capita consumption of fluid milk. Particularly concerning, is the fact that consumption of beverage milk in California has declined more rapidly than in the rest of the United States (Figure 5.)

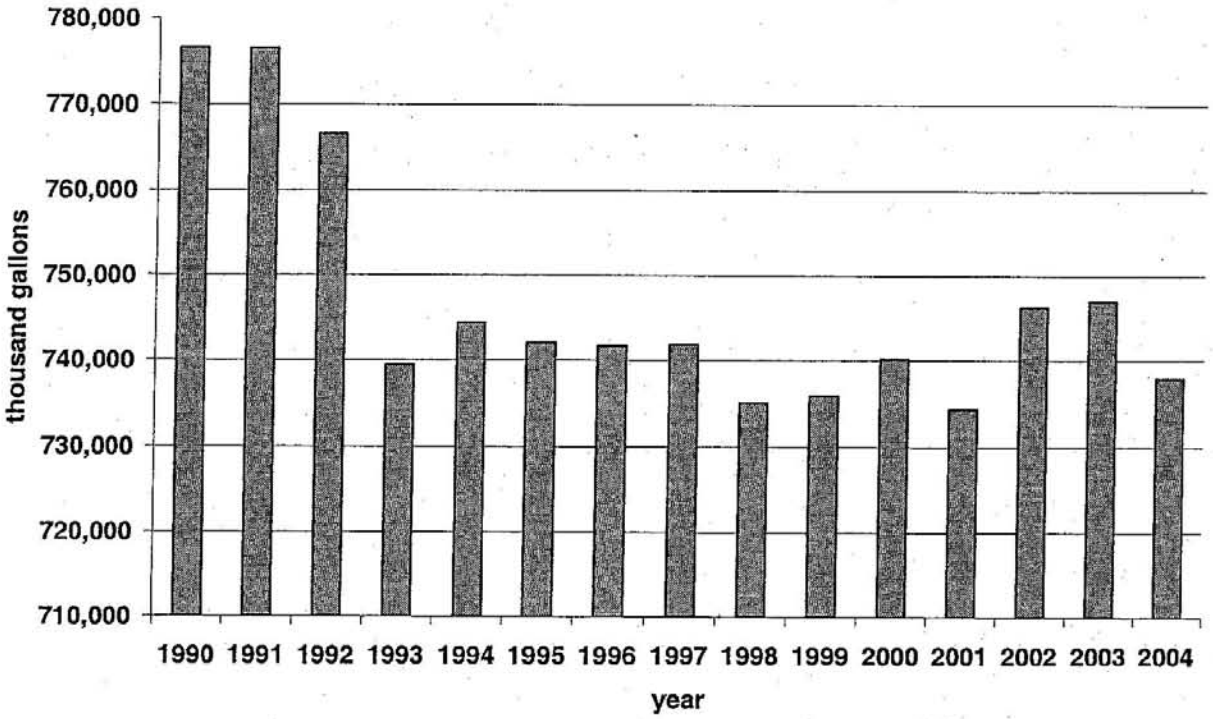
Figure 5. CA and US Per Capita Beverage Milk Sales 1980-2003



California's aggregate Class 1 sales have not returned to the high watermark they reached in 1990. California annual sales of beverage milk have fallen by almost 39 million gallons since that time. (Figure 7.) The result of current policy is that California Class 1 sales are artificially restricted because of high regulated prices, and the additional producer revenues from these high prices have encouraged, to some degree, greater levels of milk production, which must find a home in manufacturing uses. More milk in manufacturing uses has a depressing effect on the price of manufactured products, further diminishing the producer revenue benefits hoped for in establishing Class 1 prices at higher levels. The current policy is not sound because it serves to

reduce Class 1 consumption in the face of a growing milk supply. California Class 1 consumers should receive some of the benefit of plentiful milk supplies in the state. Currently, they do not.

Figure 7. California Beverage Milk Sales, 1990-2004



It also bears mentioning that fluid milk consumers are not a homogeneous group. Tracking studies of fluid milk consumption have noted distinct differences in milk consumption by age group. Data suggest that children under 12 consume 18% more milk than average, while children 12 to 17 years old consume 10% more milk than the average consumer in California. Consumers aged 50 and older drink 22% less milk on average. The implication here is that the largest consumers of fluid milk are families with children at home, while consumers in their peak income earning years consume significantly less milk. We have noted already that the burden for supporting California dairy farm incomes falls disproportionately on California's fluid milk consumers, but within this group the heaviest burden falls on families with children at home, a group that policy makers usually seek to protect through a variety of programs. It is unsound and wasteful public policy to heavily tax a particular constituent group with one policy, while offering support to the same group through other policies.

At past hearings, producer groups have offered testimony suggesting that consumers do not benefit from lower Class 1 prices. We have been treated to stories about the miniscule farm milk value of a glass of milk served at the San Francisco Airport and other such assorted anecdotes. The argument typically made comes down to the assertion that consumers do not see the benefit of lower Class 1 prices because of the market power of food processors and retailers, who are

alleged to keep the benefits of lower Class 1 prices to themselves. As evidence for this assertion, producer groups usually point to the long-term growth in the farm-retail price spread. However, they generally present no evidence to support the claim that the increase in the spread is due to market power. In reality, the spread has grown because of unequal growth rates in the productivity of milk production in relation to food processing and retailing. The dramatic increases in milk yield per cow that have occurred, and are still occurring, are a testament to the ingenuity of dairy farmers in adopting improved management practices, new technology, and advances in dairy genetics. Virtually every year there is more milk per cow and a greater number of cows per farm, changes which have resulted in a declining real cost of producing milk. However, try as they might, milk processors and grocery retailers have not found a way to deliver 101 pounds of milk to retail when given 100 pounds of farm milk. Processors and retailers have reached physical limitations with respect to productivity growth, while dairymen have not yet reached those limitations. While these differences persist, the long-term farm-retail price spread will continue to grow.

With regard to transmission of farm milk price changes, the evidence is clear that, in California at any rate, consumers do benefit from reductions in the Class 1 price. As the Department noted in the "Hearing Background Resource" for this hearing: "*California Milk Marketing Margins* by Hoy F. Carmen, Department of Agriculture and Resource Economics, University of California, Davis. Professor Carmen found "*...that there is a strong direct relationship between retail and farm level milk prices – retailers increase and decrease their prices equally in response to f.o.b. prices increases and to f.o.b. price decreases.*" The Department goes on to say that Professor Carmen's conclusion is partially born out by the relationship between the change in farm and the change in retail prices for San Francisco shown in Figure 9 of their exhibit (HE-8b). They note that the change in raw product cost explains 98% of the changes in retail prices at club stores, and 61% of the changes in prices at traditional retail stores. The 61% figure increases to 94% with lagged data, according to the Department. Hence, it is clear that consumers will benefit from a reduction in the regulated Class 1 price, and the reduction we propose is needed to assure that prices to consumers are fair and reasonable.

V. The Relationship to Prices in Surrounding States is not Reasonable

Current Class 1 prices are not in a reasonable relationship to prices in surrounding states. Contrary to the arguments of producer groups testifying at this hearing. The term reasonable relationship **does not** mean, "prices that are equal to those in other states." In determining the meaning of a statute, courts will often turn to the legislative history surrounding that statute. The only objective legislative history available on Section 62062.1 is the history of amendments made to the bill that resulted in this section of the Code being implemented. In early versions of the bill, producers had attempted to insert language that would have set California prices at a level 10 cents per hundredweight less than the six month average of prices received in surrounding states (see Attachment 5). This language was ultimately rejected by the legislature and the term "reasonable relationship" to prices in surrounding states was adopted instead. If the legislature had meant for the term "reasonable relationship" to mean "equal Class 1 prices", they clearly had an opportunity to adopt specific language to that effect. However, they explicitly chose to reject such language in favor of the term "reasonable relationship." Therefore, the

legislature clearly did **not** mean that the term, "reasonable relationship" should be interpreted in all cases and at all times to mean "equal prices."

In the absence of specific legislative history defining what a "reasonable relationship" might be, courts refer to the "plain meaning" of the statute. Webster's New Collegiate Dictionary defines "reasonable" in one sense as "inexpensive," as in: "did you buy it at a reasonable price?' However, the most likely definition from Webster's for reasonable is: "agreeable to reason." The word reason is defined as: a) a statement offered in explanation or justification, b) a rational ground or motive, or c) a sufficient ground of explanation or of logical defense...that supports a conclusion. The foregoing arguments on the need for a reduction in Class 1 prices, when taken together, constitute a logical defense that the Class 1 price level we propose would be in reasonable relationship with prices in surrounding states, because it is a price level that is supported by the economic principles of milk marketing and by sound public policy goals. A reasonable relationship with regard to California milk prices thus takes into account the differences in the structure of the markets in the different states, the differences in the competitive environment between regions, and other relevant economic factors. In short, given the current market structure in California and in surrounding states, which we have explained in detail during our testimony here today, a reasonable relationship is one where California Class 1 prices are significantly lower than those in surrounding states. Those who argue that the term "reasonable relationship" in Section 62062.1 means "equal prices" are ignoring both the legislative history of the statue and the plain meaning of the word "reasonable."

VI. Failure to Foster Uniform Prices To Handlers

The current plans fail to foster uniform prices to processors competing in a marketing area. Exempt producer distributors (P-Ds) have an advantage in the marketplace because they incur no pool obligation on their exempt quota holdings. The advantage is usually calculated as the difference between the Class 1 price and the quota price (which is assumed to be the P-D's opportunity cost of its quota holdings). Thus, the higher the regulated Class 1 price relative to manufacturing class prices, the higher will be the P-D advantage on his or her exempt milk (Figure 8). The advantage on the exempt portion of the P-Ds production has averaged $1.30 per hundredweight or 11.2 cents per gallon in Southern California and $1.02 per hundredweight or 8.8 cents per gallon in Northern California since April 2000 (the last time the Class 1 formula was changed (Figure 9)). Currently P-Ds account for 20 % of all California Class 1 sales, and the exempt portion of the production is 20% of their total Class 1 usage. Another way to look at the P-D advantage is that it equals 2.23 cents per gallon on their entire Class 1 sales ($0.112 x .20) in Southern California and 1.76 cents per gallon ($0.088 x 0.20) on their total sales in Northern California. In a business where accounts are won and lost on price differences of a few hundredths of a cent per gallon, these P-D advantages are enormous. Given the fact that P-Ds account for 20% of Class 1 sales, such differences cannot be dismissed as trivial, they constitute a glaring violation of the principle of equal raw product cost, which the legislature has directed the Secretary to endeavor to achieve. The P-D advantage can be reduced if the Class 1 price differential is reduced, as we propose. The directives given by the legislature to the Secretary require such a reduction.

Figure 8. Northern California Class 1 Price Differential v. P-D Advantage, Jan 1999 - Mar 2005

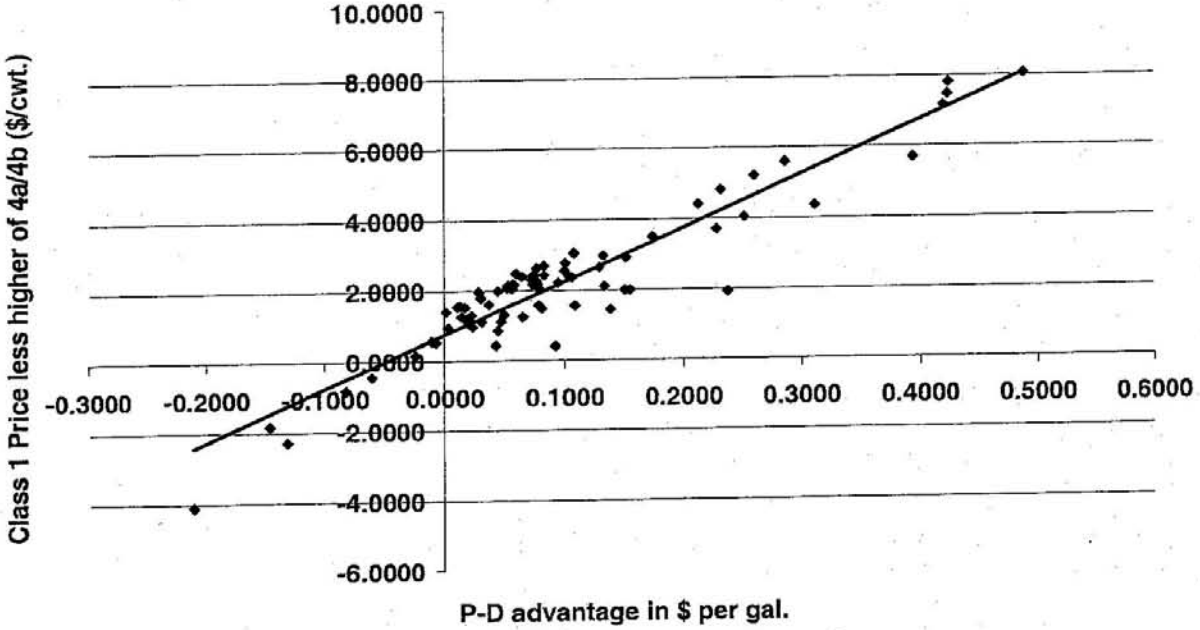
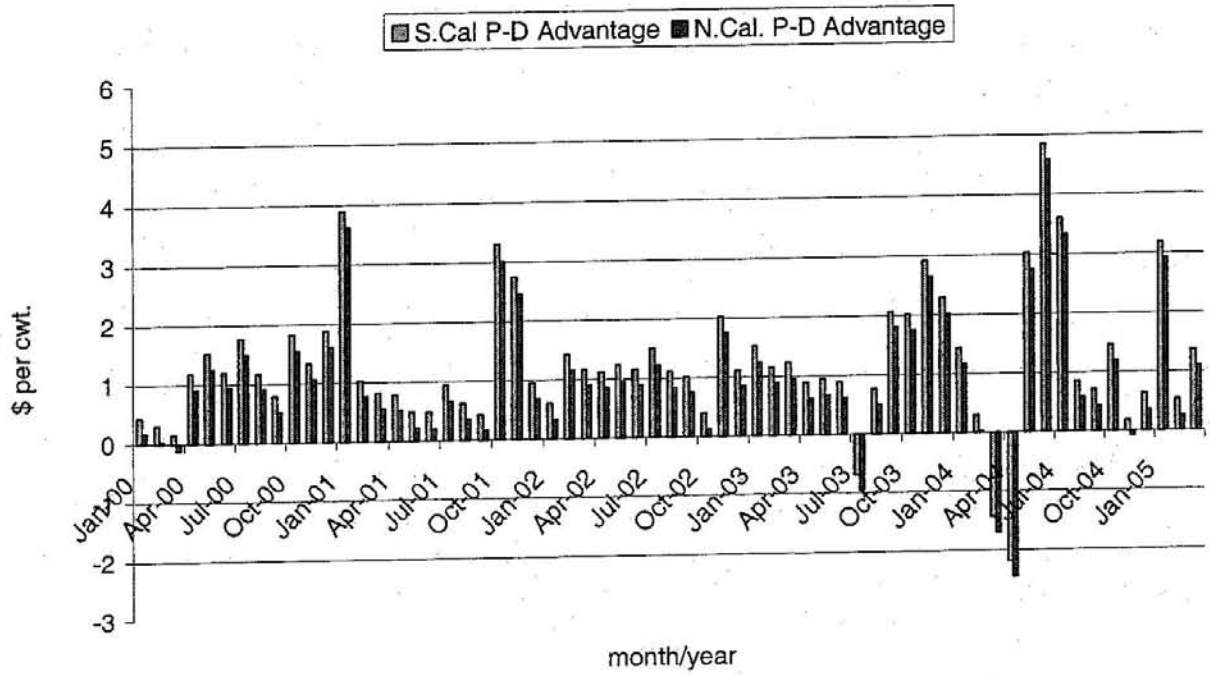


Figure 9. California Producer-Distributor Advantage, 2000-2005



VII. Failure Promote Orderly Marketing and Discourage Economic Waste

The Secretary is directed to consider other relevant economic factors in establishing Class 1 prices. The economic incentives in the marketplace cannot be ignored. Currently, economic incentives exist whereby unregulated packaged milk is moving into Southern California. Other economic incentives exist that would allow processors the opportunity to procure raw milk supplies by alternative means from inside and outside the state at a net cost that is below the regulated Class 1 price. Members of Dairy Institute will present more information on these incentives later in this hearing. It is not sound economic policy to establish minimum prices at levels that discourage the use of the closest milk in serving the state's Class 1 market. Class 1 prices must be lowered so that nearby milk can be used to supply local markets. This change would be an economically efficient policy and would promote more orderly and intelligent production and marketing of milk as directed by the legislature and would discourage economic waste.

The Department noted the following in its Statement of Determinations stemming from the February 1997 Stabilization and Marketing Plan hearings: "...Given the legislative declarations that it is not in the public interest to promote or encourage economic waste or inefficient marketing of milk, and that California has a plentiful supply of milk produced at the lowest cost in the nation, it is appropriate to question what public interest is being served by creating artificial high price signals which encourage milk shipments into California in both bulk and packaged form." We concur with the Department that the public interest is not served when economic incentives exist within the regulated market pricing system that cause, directly or indirectly, inefficient and disorderly movements of milk. To eliminate such incentives for economic waste, the Class 1 price differentials should be reduced as we have proposed.

Other Concerns

We wish to raise a point on the use of transshipment or transportation models to determine Class 1 price levels. At past hearings, there has been much discussion about the Class 1 price levels suggested for California in the Federal Order pricing map and in the research supporting that map, which was conducted at Cornell University. The basic model underlying the analysis presented in that research is a transshipment model of the U.S. dairy industry known as the U.S. Dairy Sector Simulator. A transshipment model solution shows the minimum cost of assembly, processing and distribution for the commodity and products being modeled. A particularly useful aspect of these models is their ability to determine the relative values of the commodity at given locations (shadow prices).

However, it is important to recognize that the shadow prices the model produces are an indicator of relative value across space, not of absolute value. Thus, while such models are useful in describing differences in economic values at various locations, they cannot predict or prescribe the optimal commodity value at any one location. To obtain the Class 1 differentials from the model, a starting value must be assigned at a particular location. The starting value can be more or less an arbitrary price or it can be a price designed to achieve some policy goal, such as

revenue neutrality. The point here is that Class 1 prices cannot simply be pulled from this modeling exercise and assumed to be correct for any given location. Therefore, great care must be taken when interpreting the output of these models and applying them to a specific case such as Class 1 pricing decisions in California.

Other Proposals

We oppose the proposals of California Dairy Campaign (CDC), Western United Dairymen (WUD), and The Alliance of Western Milk Producers (Alliance). All three proposals would increase effective Class 1 price differentials, and we have argued at length that a decrease is warranted. Another issue that all three proposals have in common is that they would reduce the area differential between Northern and Southern California. The current 27-cent per hundredweight difference between Northern and Southern California Class 1 prices should be maintained because it is part of the funding mechanism for plant-to-plant milk movements. Over the past few years, milk production in Southern California has been declining and recent transportation cost increases would suggest that if anything, the area differential should be increased not decreased. Milk marketing studies which predict the relative, though not the absolute, level of Class 1 prices (Pratt et al.) have also showed that economic factors dictate a price differential between Northern and Southern California approximating the current 27 cents. In our view, there is no valid justification for changing the area pricing differential at this time.

California Dairy Campaign

Dairy Institute opposes CDC's proposal to base California Class1 prices on the federal order Class I price mover. CDC has a long history of attempting to bring about federal-order-based pricing within the California state marketing orders. The basic problem with their proposal is that CDC is asking the Department to price Class 1 milk based on the Federal Order Class 1 price mover.

The Federal Order mover is calculated with the most recent National Agricultural Statistics Service (NASS) data available by the 23rd of the prior month. Since NASS data is weekly and comes out only on Friday, the actual release date of the Federal Class 1 mover depends on the calendar composition. The mover can be released as early as the 17th of the prior month or as late as the 23rd of the prior month. California Class 1 prices are currently released by the 10th of the prior month but could be as early as the 8th (or even the 7th if the 10th falls on a holiday Monday when the markets are closed).

A problem with CDC's proposal is that it would delay the ability of fluid bottlers to give notice of price changes to customers by at least a week, and perhaps as much as two weeks. Also, because the NASS data lag the Chicago Mercantile Exchange (CME) markets, the Class 1 prices calculated from the Federal Order mover translate dairy market price signals back to producers in a slower fashion than do current California formulas. A third problem is that pricing California Class 1 based on the Federal Order mover would relate the state's Class 1 prices to the prices of Federal Order manufacturing milk classes, rather than to the California manufacturing classes as required by statute.

Western United Dairymen

We oppose the effort to increase Class 1 prices in Northern California relative to Southern California for the reasons we stated previously.

Alliance of Western Milk Producers

There Alliance's proposal does not advance the legislative goals for the Stabilization and Marketing Plans set forth by the legislature. The Alliance is consistent in that they generally propose Class 1 price increases any time that Dairy Institute proposes Class 1 reductions. Based on their historical pattern at these hearings, the Alliance seems less interested in adhering to the requirements of Section 62062.1 (as they suggest in their proposal), and more interested in steering the Secretary toward a neutral result, acting as a counterweight to Dairy Institute. We have already made the case that the term "reasonable relationship" does not mean equal Class 1 prices with surrounding states. Even if it did, as the Alliance seems to believe, their proposal conveniently ignores Class 1 prices in Las Vegas, which have averaged below California prices for many years. In our view, the Alliance proposal is without merit and must be rejected.

Summary

We urge the Department to adopt our proposal. The current Class 1 pricing structure in California makes sense only if the sole goal of the program is producer income enhancement. The legislature directs the Department to balance the needs of producers, processors, and consumers in a manner such that the public interest is served. There is no evidence that adoption of our proposal will result in insufficient producer income to ensure adequate supplies of market milk. There is evidence, however, that adoption of our proposal will result in lower fluid milk prices to consumers and will put the Stabilizations and Marketing Plans back into compliance with their legislative requirements.

As a final point, we wish to note that the hearing panel always does an excellent job of analyzing and evaluating the merits of the testimony presented at these hearings. While we have sometimes disagreed with the panel's conclusions stemming from past hearings, we respect their abilities and their capable analysis of dairy marketing issues. We again urge the Secretary to rely on the report and recommendations of the hearing panel. The panel's expertise puts them in a unique position to evaluate the relative merits of the various presentations made here today.

Thank you for this opportunity to testify. I am willing to answer any questions you may have at this time. We also respectfully request that the Department grant us a period for the filing of a post-hearing brief.

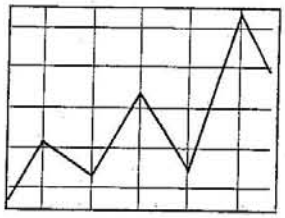
Attachment 1

Table 33--Federal Milk Order Principal Pricing Points, with Class I Differentials

Federal Milk Order	Principal Pricing Point	Major City in Principal Pricing Point	Class I Differential for:	
			Principal Pricing Point	Other Major Cities in the Order
Northeast	Suffolk Co., MA	Boston	$3.25	New York City, $3.15; Philadelphia, $3.05; Baltimore, $3.00; and Washington, DC, $3.00
Appalachian	Mecklenburg, Co., NC	Charlotte	$3.10	Knoxville, $2.80 and Louisville, $2.20.
Southeast	Fulton Co., GA	Atlanta	$3.10	New Orleans; $3.60; Memphis, $2.80; Nashville, $2.60; and Springfield, MO., $2.20
Florida	Hillsborough, Co., FL	Tampa	$4.00	Orlando, $4.00 Miami, $4.30; and Jacksonville, $3.70.
Mideast	Cuyahoga Co., OH	Cleveland	$2.00	Indianapolis, $2.00; Cincinnati, $2.20; Pittsburgh, $2.10; and Detroit, $1.80
Upper Midwest	Cook Co., IL	Chicago	$1.80	Milwaukee, $1.75; and Minneapolis, $1.70.
Central	Jackson Co., MO	Kansas City	$2.00	Des Moines, $1.80; Omaha, $1.85; Oklahoma City, $2.60; St, Louis, $2.00, and Denver, $2.55.
Southwest	Dallas Co., TX	Dallas	$3.00	Houston, $3.60; San Antonio, $3.45; Albuquerque, $2.35; and El Paso, $2.25
Arizona-Las Vegas	Maricopa Co., AZ	Phoenix	$2.35	Las Vegas, $2.00.
Western	Salt Lake Co., UT	Salt Lake City	$1.90	Boise, $1.60.
Pacific Northwest	King Co., WA	Seattle	$1.90	Portland, $1.90; and Spokane, $1.90.

Attachment 2

MARKETING AND POLICY BRIEFING PAPER



Department of Agricultural and Applied Economics, College of Agricultural and Life Sciences, University of Wisconsin-Madison
Cooperative Extension, University of Wisconsin-Extension

Paper No. 84
November 2003

Cost of Producing Milk: A Comparison by State

Ed Jesse and Bruce Jones[1]

Starting in January 2003, the Economic Research Service (ERS) of USDA resumed reporting cost of production (COP) estimates for milk for selected states. According to ERS, the resumption of reporting was motivated by, "..... language in USDA's 2003 appropriation that strongly urged USDA to make available monthly estimates of COP for milk production in various areas of the United States."[2]

ERS dairy cost of production estimates have been subject to criticism on several grounds, including treatment of purchased versus home-grown feeds and computation of (non-cash) opportunity costs, especially for unpaid labor. Despite this criticism, ERS estimates are the only known source of ***consistent*** dairy cost of production estimates across states and regions — the estimates are derived in exactly the same fashion for each state. This makes these data a good source for making interregional COP comparisons, even though better cost estimates might be available for individual states.

In this paper, we dissect ERS milk cost of production estimates to provide some insights into the competitiveness of the Wisconsin dairy industry. We use monthly state estimates averaged over the six-month period January-June 2003. These estimates are based on USDA's Agricultural Resource Management Survey conducted in 2000, updated using indexes reflecting current monthly values for production inputs, services, and wages reported by USDA's National Agricultural Statistics Service (NASS). ERS notes that annual estimates are more reliable than monthly estimates, but annual estimates are published only for six broad regions rather than states.

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[1] Jesse and Jones are Professors and Extension Dairy Marketing and Farm Management specialists, respectively in the Department of Agricultural and Applied Economics, University of Wisconsin-Madison/Extension. Jones is also Director of the University of Wisconsin Center for Dairy Profitability.

[2] http://www.ers.usda.gov/Data/CostsAndReturns/monthlymilkcosts.htm. This site also contains the COP spreadsheets.

ERS costs by category for Wisconsin and two major cheese competitors, California and Idaho, are shown in the following table.

Table 1: ERS Average Costs of Production for Dairy, Jan-Jun 2003

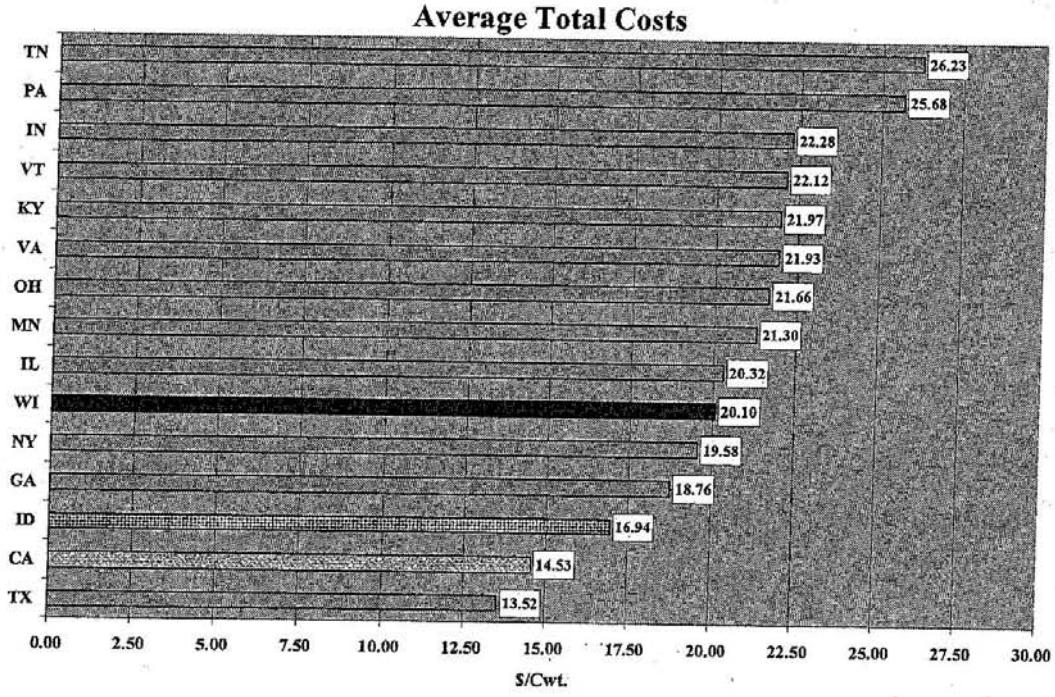
	WI	CA	ID
	\$/Cwt. Of Milk Sold		
Operating costs:			
Feed--			
Feed grains	1.73	1.34	1.94
Hay and straw	0.78	2.24	2.55
Complete feed mixes	0.67	2.11	0.39
Liquid whey and milk replacer	0.12	0.04	0.02
Silage	1.20	0.76	0.87
Grazed pasture and cropland	0.08	0.05	0.05
Other feed items 1/	1.13	0.71	1.41
Total, feed costs	5.71	7.26	7.23
Veterinary and medicine	0.69	0.44	0.64
Bedding and litter	0.18	0.05	0.15
Marketing	0.20	0.19	0.32
Custom services	0.29	0.44	0.33
Fuel, lube, and electricity	0.61	0.49	0.37
Repairs	0.55	0.47	0.63
Other operating costs 2/	0.00	0.01	0.04
Interest on operating capital	0.11	0.13	0.14
Total operating costs	8.34	9.48	9.85
Allocated overhead:			
Hired labor	1.39	1.21	1.44
Opportunity cost of unpaid labor	4.91	1.00	2.12
Capital recovery of machinery and equipment	4.60	2.41	2.99
Opportunity cost of land (rental rate)	0.08	0.01	0.04
Taxes and insurance	0.23	0.14	0.12
General farm overhead	0.57	0.29	0.37
Total, allocated overhead	11.77	5.05	7.09
Total costs listed	20.10	14.53	16.94
Total Costs less Unpaid Costs 3/	10.40	10.99	11.65

1/ Cotton seed meal, protein supplements, protein by-products, alfalfa cubes or pellets, green chop, corn stalks, and antibiotics and other medicated additives.
2/ Manure handling.
3/ Unpaid costs include: Interest on Operating Capital, Unpaid labor, Depreciation, and Opportunity cost of land.

Average Total Costs

Using ERS "bottom line" average total costs of production to assess the competitive position of dairy farms paints a grim picture for all of the included states — grimmer for some than others. The range in average costs of producing milk is from $13.50 per hundredweight in Texas to $26 in Pennsylvania and Tennessee. In all cases, average production costs are higher than mailbox prices reported for the same states, and in some states, losses of more than $10.00 per hundredweight are implied.

Wisconsin dairy farms are reported to have costs of production just over $20 per cwt. This is below costs reported for most of the states included, but it is still well above the costs of production reported for Idaho and California. From January through June, 2003, the simple average mailbox price reported by the Agricultural Marketing Service for Wisconsin was $11.04 per hundredweight. This implies Wisconsin dairy farmers experienced losses of over $9 per hundredweight during the first six months of 2003.



Attachment 3

Which areas have been most profitable the last five years?

by Hoard's Dairyman staff

FIVE years into the new century, not much seems to have changed in regard to the roller-coaster ups and downs of dairy profitability that were so common in the old one.

Generally speaking, owning cows was a good business strategy two of the last five years (2001 and 2004), not so good in two (2002 and 2003), and OK in one (2000). Equal parts feast and famine, plus a dash of ho-hum is a financial recipe that has cooked up a surprisingly wide variety of dishes in the West so far in the 21st century, according to data gathered by the nation's largest dairy accounting firm.

As seen in the accompanying table from Genske, Mulder & Co. LLP Certified Public Accountants, all seven areas of the West where the firm has clients are, on average, on the profit side of the profit and loss statement for the latest five-year period. Some are well into the black, while two might still be in the red if not for an exceptional 2004.

(Data in the table was gathered from about 400 dairies which together account for 10 percent of total U.S. milk supply. Average herd size is well over 1,000 head, and many have more than 2,000.)

As the saying on Wall Street goes, "Past performance is no guarantee of future results," but in this case it suggests that some places may have milk cost of production advantages.

Area differences . . .

The seven areas summarized in the table fall into three clear financial groups during the last five years:

– Washington, California, and New Mexico have done OK.

– Texas and Idaho have done less OK.

– The High Plains and Arizona have struggled.

Bruce Miles, a partner at Genske, Mulder & Co., says dairies in the top three areas tend to have two key similarities: large herds and high-producing cows.

"No debt is the ideal for any dairy, of course, but high production per cow often explains more about who is profitable," he adds. "Smaller herds can be older, which means debt load can be less, but fewer cows can also mean overhead is spread over fewer animals."

Although Washington has a slight edge in five-year average net income (profit) per cow – mainly due to a substantial income per cow advantage – Miles says the difference between the top three states is almost too small to notice except on paper.

Texas and Idaho fall into the financial performance middle in much different ways. Texas has had the highest milk prices of any area, but almost the highest cost of production as well. Idaho has had the lowest milk prices but almost the lowest cost of production.

Arizona and the High Plains have fared significantly worse than the rest of the West and again for much different reasons. In Arizona, producer payments to cover losses by the state's only cooperative have been painful. In the High Plains, milk prices have been high but production costs have been huge.

Perhaps the most most revealing data of all in the table points to just how good a year 2004 was.

Although figures shown are only for the first nine months, net income per cow in 2004 already rates as the best year for five of the seven areas. Miles says fourth quarter results will be good, but not as good as earlier in the year.

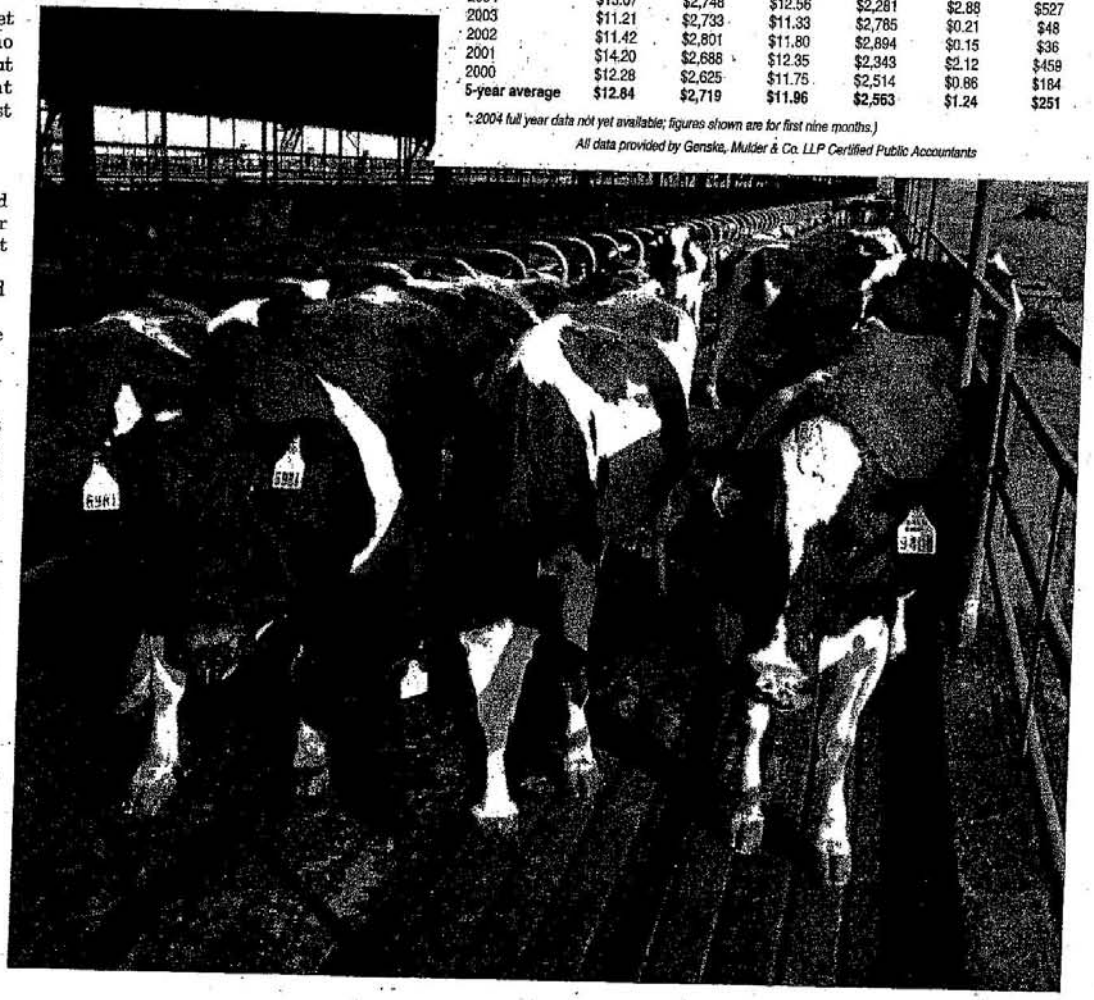
On the other hand, he expects 2005 up to be another very good year to own cows, perhaps even as good as 2004.

If so that would be two years in a row – which might not be enough to qualify as a trend, but producers would love to see it anyway.

	mailbox price	income per cow	cost of production	cost per cow	net income	net per cow
Arizona						
2004*	$15.58	$2,388	$13.75	$2,112	$2.16	$336
2003	$12.12	$2,332	$13.11	$2,519	($0.66)	($124)
2002	$11.51	$2,189	$12.93	$2,460	($0.93)	($178)
2001	$14.99	$2,548	$12.78	$2,063	$1.75	$310
2000	$12.06	$2,081	$12.50	$2,158	($0.39)	($57)
5-year average	$13.12	$2,308	$13.01	$2,262	$0.40	$57
California						
2004*	$14.94	$2,606	$12.24	$1,891	$3.22	$495
2003	$11.53	$2,327	$11.89	$2,402	$0.27	$53
2002	$11.19	$2,277	$11.90	$2,420	($0.06)	($12)
2001	$14.06	$2,792	$11.90	$2,361	$2.60	$517
2000	$11.62	$2,348	$11.94	$2,291	$0.76	$153
5-year average	$12.67	$2,410	$11.85	$2,273	$1.36	$241
High Plains						
2004*	$16.12	$2,261	$14.67	$2,058	$1.89	$264
2003	$13.27	$2,378	$13.66	$2,476	($0.15)	($20)
2002	$13.12	$2,328	$14.29	$2,536	($0.03)	($5)
2001	$14.94	$2,446	$14.71	$2,409	$0.70	$115
2000	$12.63	$2,256	$13.27	$2,370	($0.10)	($17)
5-year average	$14.02	$2,334	$14.16	$2,370	$0.46	$67
Idaho						
2004*	$15.62	$2,343	$12.72	$1,909	$2.64	$394
2003	$11.81	$2,326	$11.82	$2,326	$0.24	$49
2002	$11.32	$2,285	$11.96	$2,414	($0.83)	($66)
2001	$13.34	$2,510	$11.90	$2,242	$1.63	$335
2000	$11.06	$2,028	$11.60	$2,127	($0.27)	($50)
5-year average	$12.63	$2,298	$12.00	$2,204	$0.78	$132
New Mexico						
2004*	$15.21	$2,270	$12.96	$1,935	$2.70	$405
2003	$12.00	$2,270	$12.21	$2,311	$0.18	$34
2002	$11.99	$2,271	$12.47	$2,362	$0.39	$74
2001	$15.02	$2,769	$13.01	$2,401	$2.38	$439
2000	$12.53	$2,445	$11.83	$2,308	$1.10	$215
5-year average	$13.35	$2,405	$12.50	$2,263	$1.35	$233
Texas						
2004*	$16.19	$2,457	$14.01	$2,131	$2.62	$393
2003	$13.27	$2,519	$13.74	$2,606	($0.01)	$0
2002	$13.08	$2,527	$13.53	$2,614	$0.38	$74
2001	$15.92	$2,814	$14.52	$2,564	$1.68	$297
2000	$13.50	$2,523	$13.20	$2,467	$0.68	$128
5-year average	$14.39	$2,568	$13.80	$2,476	$1.07	$178
Washington						
2004*	$15.07	$2,748	$12.56	$2,281	$2.88	$527
2003	$11.21	$2,733	$11.33	$2,785	$0.21	$48
2002	$11.42	$2,801	$11.80	$2,894	$0.15	$36
2001	$14.20	$2,688	$12.35	$2,343	$2.12	$459
2000	$12.28	$2,625	$11.75	$2,514	$0.86	$184
5-year average	$12.84	$2,719	$11.96	$2,563	$1.24	$251

**: 2004 full year data not yet available; figures shown are for first nine months.)*

All data provided by Genske, Mulder & Co. LLP Certified Public Accountants



Attachment 4

54

UPPER MIDWEST FEDERAL ORDER COALITION

Testimony of
Paul G. Christ

Proposal No. A-27

INTRODUCTION

My name is Paul G. Christ. I am Vice President for Dairy Planning and Analysis at Land O'Lakes, Inc. My business address is 4001 Lexington Avenue North, Arden Hills, Minnesota 55126. I have been employed by Land O'Lakes since 1974 and have been active in securing changes in Federal milk marketing orders ever since. Additionally, I have been responsible for the marketing of Grade A milk for Land O'Lakes since 1978. My previous experience was with the Dairy Division of the Agricultural Marketing Service of USDA, working both in market administrator offices and in the Washington, D.C. headquarters of the Dairy Division.

I appear here as a proponent of proposal No. A-27, on behalf of the Upper Midwest Federal Order Coalition. The participants in that Coalition are listed on Attachment No. 1. We represent the majority of the dairy farmers in Minnesota, Wisconsin, and part of Iowa and Northern Illinois. We represent their economic and political interest as marketing organizations, farm organizations, and state governments.

The previous witness for the Coalition presented a thorough discussion of the problems we see with certain aspects of the current Federal milk marketing order system. Before proceeding to the specific elements of our proposal, I want to take a minute to state the objectives we have for this undertaking.

First, we want to see a Federal order system that allows the marketplace to operate efficiently and effectively. We recognize that the orders do not and should not replace the marketplace. However, orders should reflect the basic workings of the marketplace.

Second, orders should assure that adequate supplies of Grade A milk be made available for fluid use.

Finally, orders should provide an incentive for milk to move to fluid markets.

Our proposal, which is detailed in Attachment No. 2, attempts to address the problems we see with the present system in the context of these objectives.

Class I Pricing Standards

The level of Class I price in individual orders must adhere to the pricing standards in the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. 601 et seq.) as interpreted by the Secretary. H.L. Forest, former Director of the Dairy Division/AMS/USDA explained to Congress the pricing standard in the Act as follows:

> "The pricing standard under Federal milk orders is a supply-demand standard. The Act states that the Secretary shall set prices at levels which will reflect '... the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk or its products in the marketing area ... (and which will) insure a sufficient quantity of pure and wholesome milk and be in the public interest.' As a practical matter, this means that prices under milk orders should be at levels which are tending to achieve an appropriate balance between supply and demand, taking into

account the maintenance of adequate reserves to accommodate daily, weekly, and seasonal fluctuations in supplies and sales ..."[1]

Further elaboration of the pricing standards for Class I milk as implemented by the Secretary is presented in Marketing Bulletin No. 27 as follows:

* * *

"Class I differentials were established at levels which, in conjunction with the dairy price support program, will insure present and future supplies of high-quality milk throughout the Federal order system."

* * *

"Factors considered in establishing Class I differentials include: (1) Additional costs of meeting Grade A sanitary regulations; (2) Costs of transporting milk from areas of production to areas of consumption; (3) The cost of producing milk in the supply area; and (4) Supply and demand conditions for milk, including the cost of alternative supplies."[2]

[1] Forest, H.L., Statement Before the Subcommittee on Dairy and Poultry, Committee on Agriculture, U.S. House of Representatives, July 17, 1979.

[2] Dairy Division, AMS-USDA, The Federal Milk Marketing Order Program, Marketing Bulletin No. 27, Agricultural Marketing Service, U.S. Department of Agriculture, January 1989, pp. 21-23.

In summary, the appropriate criteria are:

1. Class I prices should reflect economic conditions that affect the market supply and demand for milk.

   The primary mechanism by which Class I differentials reflect supply and demand conditions is through the use of the Minnesota-Wisconsin price in the formula. The Minnesota-Wisconsin price represents the value of milk that is residual to all other uses. Changes in demand for any one use of milk in any part of the country are reflected back through the value of manufactured dairy products and eventually to the competitive price paid for manufacturing grade milk.

   Similarly, changes in the supply of milk on a local or national basis will be reflected back to manufacturing milk prices.

   The Class I differential has an impact on supply and demand conditions. It has a direct effect on the cost to fluid procesors for Grade A milk disposed of as Class I products. It, therefore, affects the demand for fluid milk products.

   The Class I differential also influences the local supply of milk through the blend price. In 1989, for example, the weighted average blend price in all Federal order markets was $13.30 per hundredweight. During the same year, the Minnesota-Wisconsin price averaged $12.37. Thus, the Class I and Class II differentials contributed $0.93 to the pay prices received by producers. This represents seven percent of the price.

The remaining ninety-three percent of Federal order blend prices represents manufacturing milk values. Thus, whether the national milk supply is adequate for Class I or any other use depends both on the manufacturing milk price and on Class I or Class II differentials. Class I prices include the competitive value of manufacturing milk (the Minnesota-Wisconsin price) as a major factor and, as a result, they reflect the economic conditions that affect the market supply and demand for milk.

2. Class I prices should assure an adequate supply of pure and wholesome milk for fluid use.

The Class I price must perform two functions to assure an adequate supply of Grade A milk for fluid use. It must provide sufficient incentive to producers through the blend price to attain and maintain Grade A status, and it must provide incentive for the delivery of Grade A milk to fluid processors.

This standard has often been applied on a local market basis. However, we believe that it is more appropriate to apply it on a system-wide basis. First, is there sufficient Grade A milk produced to fulfill fluid needs? The answer is clearly yes, as only 45.2 percent of the Grade A milk pooled under Federal milk orders in 1989 was disposed of as Class I milk.[3]

[3] Federal Milk Order Statistics, 1989 Annual Summary, Statistical Bulletin No. SB-810, AMS/USDA, July 1990.

Second, do adequate incentives exist to attract the available Grade A supply to fluid processors? The answer is probably no. Fluid processors in the Upper Midwest Region have trouble getting producers and operators of milk manufacturing plants to ship milk for Class I use, and fluid processors in seasonally deficit markets have trouble securing supplemental milk supplies from nonpool sources.

There are several reasons for this difficulty. Potential suppliers to fluid processors face significant costs associated with pool participation. Grade A milk must be assembled separately from manufacturing grade milk, an isolated Grade A facility must be maintained, administrative fees must be paid, manufacturing margins are reduced when shipments are made, and hauling costs are incurred on shipments in many markets.

This state of affairs implies that Class I prices under Federal milk orders have provided too much incentive for the production of Grade A milk and too little incentive for its allocation to the fluid market.

3. <u>Class I prices should assure a level of farm income adequate to maintain production capacity sufficient to meet anticipated future needs</u>.

This is a long run supply standard. It appears to be fully met under present conditions. If the Grade A milk supply was half of its current level, there would be sufficient remaining production to meet the needs of the fluid market. The problem would still be how to get it allocated to the fluid market.

4. Class I prices should reflect the public interest.

As quoted above, USDA says "The 'public interest' is served by an adequate supply of milk at a reasonable price." Adequate supply is a function of incentives to produce Grade A milk and allocate it to fluid use. Reasonable price is a function of efficiency. We argue that the public is entitled to a Federal milk order program that mandates the prices that are compatible with the efficient provision of an adequate supply.

The Proposal

Proposal No. A-27, as modified, contains three building blocks for establishing the Class I price for each order in the system. They are:

1. The basic formula price for the second preceding month.

2. A uniform Class I base differential of $1.80 for all markets.

3. A marketwide service differential based on the hauling costs associated with delivery of pool and nonpool milk to pool distributing plants, which would be unique to each order.

Before turning to each of these building blocks of the Class I price, I would like to point out that the proposal presented today does not call for national pooling of any portion of the Class I price. Although many members of the Coalition remain convinced that national pooling may be the ultimate solution to many of the problems outlined by Dr. Jesse, the Coalition has concluded that a Class I base differential that is uniform for all markets is, at this time, a sufficient means of addressing

many of the regional pricing inequities. Individual members of the Coalition may choose to pursue the case for national pooling.

Also, the Coalition recognizes that the Class I price established by any order will not be the actual price paid in the market for milk for fluid use. Over order prices have existed in the Federal milk order system for over 25 years. We are not trying to replace market prices with order prices. Conversely, we believe that the actual price for milk should be determined in the marketplace, not by orders. However, we believe that orders play an integral role in maintaining orderly marketing and that the price structure of orders should reflect the market and provide the basic incentives for assuring an adequate supply of milk for fluid use under orderly marketing conditions.

1. Basic Formula Price.

The basic formula price is an integral part of all Federal milk orders and we propose no change in its function as the base for the Class I price. No further elaboration is necessary.

2. Class I Base Differential.

This portion of the Class I price is designed to assure the production and availability of an adequate supply of Grade A milk for fluid use on a national basis within the system of location adjustments that now exist under individual orders.

This component of the Class I price has two different elements; providing a basic incentive for producers to maintain the quality standards associated with the production of Grade A milk; and a minimum price necessary to keep the Grade A milk pooled and available to adequately serve the fluid market.

The latter element is to offset costs incurred by milk manufacturers who participate in Federal milk order pools. They include the extra cost of maintaining Grade A certification of plant facilities, the Market Administrator's administrative fees that must be paid on pool milk, and the extra cost of maintaining records and filing reports to the Market Administrator.

Few would argue that the current national supply of Grade A milk is inadequate to service the Class I needs of all distributing plants regulated under Federal milk orders. Clearly, however, there are differences in the production, facility, and quality standards for the two grades of milk, and there are costs associated with maintaining the higher Grade A standards. Dr. Cropp has just given a very thorough review of these differences in costs. The research cited by Dr. Cropp and the recent study by General Accounting Office[4] conclude that it costs producers about $0.15 per hundredweight more to produce Grade A milk rather than manufacturing grade milk.

If Federal milk orders are to continue to assure the production of sufficient quantities of Grade A milk, then producers throughout the system should receive at least $0.15 more from the blend price than is available from the manufacturing milk price. The greater the proportion of reserve milk in a market, the higher the Class I price necessary to provide a $0.15 blend price benefit to producers.

[4] United States General Accounting Office Report to Congress, Milk Marketing Orders Options for Change, GAO/RCED-88-0, March 1988, p. 25.

The Chicago Regional market carries the largest absolute and relative supply of reserve Grade A milk of any market in the United States. In many respects the reserve in the Chicago Regional market is a national reserve. Thus, if the Class I price is high enough to support the reserve milk in Chicago at $0.15 per hundredweight, then it will be high enough to support the Grade A milk supply in all other markets.

The question then becomes, what level of price is necessary to return a $0.15 blend price benefit to producers in the Chicago market.

For the period, August 1989 through July 1990, the Chicago order had a Class I utilization of 15.7 percent when all the Grade A milk normally associated with the market is taken into account. See Attachment No. 3.

The statistics published by the Market Administrator show a higher Class I utilization percentage for this period because significant quantities of Grade A milk eligible to participate in the Chicago Regional pool were not pooled during the fall of 1989 due to the abnormal price relationships that existed during that period. Specifically, the rapid rise in the Minnesota-Wisconsin price in the fall of 1989 and the two month lag before M-W prices that are reflected in the Class I price caused very low and even negative differences between the Class I and Class III prices. Consequently, the blend price was the same as the Class III price so milk was not pooled. We believe that 15.7 percent is the Class I utilization percentage that reflects normal market conditions in this market for the period.

If the Class I price on 15.7 percent of the milk is to fund a blend price of $0.15 per hundredweight on 100 percent of the milk, then this element of the Class I price must be $0.96 ($0.15 ÷ .157 = $0.96). This number could be reduced if the national

Attachment 5

BILL NUMBER: AB 1285 AMENDED 05/03/93
BILL TEXT

AMENDED IN ASSEMBLY MAY 3, 1993
AMENDED IN ASSEMBLY APRIL 12, 1993

INTRODUCED BY Assembly Members Cannella, Costa, Jones, and Seastrand

MARCH 3, 1993

An act {+ to amend Sections 61802 and 62062 of, and +} to add Chapter 3.5 (commencing with Section 62750) to Part 3 of Division 21 of {+ , +} the Food and Agricultural Code, relating to food.

LEGISLATIVE COUNSEL'S DIGEST

AB 1285, as amended, Cannella. Milk: pooling referendum.

Existing law provides for stabilization and marketing plans pursuant to which the Director of Food and Agriculture establishes minimum prices to be paid by handlers to producers for market milk. Those plans may contain provisions that authorize any handler to pool the milk for producer payment purposes.

This bill would require the director to prepare and submit to a referendum vote of market milk producers a pooling plan for market milk, as specified. The bill would require the director to hold public hearings for the purpose of considering modifications to the plan. The bill would require the director, following the hearing, to submit the pooling plan to producers for their approval in a statewide election, and would specify the procedures to be followed in conducting the referendum. If the plan is not approved, the bill would require the director to continue in operation the pooling plan in effect on the date the referendum was commenced. {+ This bill would also establish, for the period beginning August 1, 1994, and ending January 31, 1996, the minimum class 1 price for milk testing 3.5% fat and 8.7% solids not fat at 10 per hundredweight less than the period 6-months weighted average announced class 1 producer price for federal milk marketing orders. +} s Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. {+ Section 61802 of the Food and Agricultural Code is amended to read: +}

61802. The Legislature hereby declares all of the following:

(a) Market milk is a necessary article of food for human consumption.

(b) The production and maintenance of an adequate supply of healthful market milk of proper chemical and physical content, free from contamination, is vital to the public health and

welfare, and the production, transportation, processing, and storage of market milk in this state is an industry affecting the public health.

(c) Because of the perishable quality of milk, the nature of milk production, the varying seasonal production and demand factors, and other economic factors affecting the milk industry, the potential exists for economic disruption, in the absence of regulation, in the production, marketing, and sale of market milk which may constitute a menace to the health and welfare of the inhabitants of this state and may tend to undermine sanitary regulations and standards of content and purity, however effectually the sanitary regulations may be enforced.

(d) Health regulations alone are insufficient to prevent economic disturbances in the production of milk which may disrupt the future supply of market milk and to safeguard the consuming public from future inadequacy of a supply of this necessary commodity.

(e) It is the policy of this state to promote, foster, and encourage the intelligent production and orderly marketing of commodities necessary to its citizens, including market milk, and to eliminate economic waste, destructive trade practices, and improper accounting for market milk purchased from producers.

(f) It is recognized by the Legislature that the economic factors concerning the production, marketing, and sale of market milk in California may be affected by the national market for milk for manufacturing purposes.

(g) It is recognized by the Legislature that in recent years the supply of manufacturing milk in California, as defined in Section 32509, has consistently declined and continues to decline, and that market milk has virtually supplanted manufacturing milk for manufacturing purposes in this state, and that it is therefore necessary to conform the pricing standards governing minimum producer prices for market milk established under this chapter to current economic conditions. {+

(h) That the weighted average announced class 1 producer price for federal milk marketing orders as authorized by the United States Congress and by decisions of the United States Department of Agriculture is fair and reasonable. +} {+

SEC. 2. Section 62062 of the Food and Agricultural Code is amended to read: +}

62062. {+ (a) +} Each stabilization and marketing plan shall contain provisions whereby the director establishes minimum prices to be paid by handlers to producers for market milk in the various classes. The director shall establish the prices by designating them in the plan, or by adopting methods or formulas in the plan whereby the prices can be determined, or any combination of the foregoing. If the director directly designates prices in the plan, the prices shall be in reasonable and sound economic relationship with the value of milk used for manufacturing purposes. If the director adopts methods or formulas in the plan for designation of prices, the methods or formulas shall be reasonably calculated to result in prices {- which -} {+ that +} are in a reasonable and sound economic relationship with the value of milk used for manufacturing purposes.

In establishing the prices, the director shall take into consideration any relevant economic factors, including, but not limited to, the following: {-

(a) -} {+

(1) +} The reasonableness and economic soundness of market milk prices in relation to the cost of producing and marketing market milk for all purposes, including manufacturing purposes. In determining the costs, the director shall consider the cost of management and a reasonable return on necessary capital investment. {-

(b) -} {+

(2) +} That prices established pursuant to this section shall insure an adequate and continuous supply, in relation to demand, of pure, fresh, wholesome market milk for all purposes, including manufacturing purposes, at prices to consumers which, when considered with relevant economic criteria, are fair and reasonable. {-

(c) -} {+

(3) +} That the prices established by the director for the various classes of market milk bear a reasonable and sound economic relationship to each other.

In establishing the prices, the director shall also take into consideration all the purposes, policies, and standards contained in Sections 61801, 61802, 61805, 61806, 61807, 62076, and 62077. {+

(b) Notwithstanding subdivision (a), for the pricing period beginning August 1, 1994, and ending January 31, 1996, and adjusted every six months, the director shall set the minimum announced class 1 price for milk testing 3.5 percent fat and 8.7 percent solids not fat at a level equal to 10 cents ($.10) per hundredweight less than the prior six months weighted average announced class 1 producer price for federal milk marketing orders. Commencing February 1, 1996, the director shall continue to use this formula until he or she determines that the prevailing current or projected economic conditions and price relationships warrant change, at which time the director may designate a price or modify the formulas or methods that more accurately reflect those economic conditions and price relationships. +} {+

SEC. 3. +} Chapter 3.5 (commencing with Section 62750) is added to Part 3 of Division 21 of the Food and Agricultural Code, to read:

CHAPTER 3.5. MILK POOLING REFERENDUM

62750. The director shall prepare and submit to a single referendum vote of market milk producers a pooling plan for market milk that contains all of the provisions of Chapter 3 (commencing with Section 62700), except as provided in this chapter. Notwithstanding Chapter 3 (commencing with Section 62700), the pooling plan shall include the following:

(a) Producers who have qualified and applied for a quota as new fluid milk producers shall be allowed to purchase a quota without jeopardizing their new entry application if two years have elapsed since their initial application date and they have not been issued a quota.

(b) Any future allocations of a quota shall not be transferred until seven years after the allocation date. Transfers to a direct lineal descendent of a producer is exempt from this transfer restriction.

(c) Any quota returned to the director shall be utilized for allocations to producers who have not reached the equalization point.

(d) All allocations of new class 1 usage determined under

subdivision (e) of Section 62707, shall be made as follows:

(1) Fifty percent to producers who have not reached the equalization point.

(2) Thirty percent to producers who have reached the equalization point.

(3) The remaining 20 percent shall be utilized for new producer allocations.

(e) A procedure for computing an announced quota price each month that shall be equal to {+ the sum of the highest announced transportation subpool charge plus +} one dollar and seventy cents ($1.70) per hundredweight greater than the announced nonquota price for milk testing 3.5 percent fat and 8.7 percent solids-not-fat. The announced quota price shall continue to be subject to location adjustments and transportation charges.

62751. After the director has formulated the proposed plan, the director shall hold a public hearing for the purpose of considering any modification of the proposed pooling plan that will best accomplish the purposes of this chapter. Notice of the public hearings shall be given to each producer, including each member of a cooperative marketing association, who ships fluid milk to a distributor, and to each distributor who receives fluid milk from producers. The procedures for giving notice and conducting the hearings shall be the same as those provided in Chapter 2 (commencing with Section 61801) for public hearings on stabilization and marketing plans.

62752. Following the required hearing, the director shall submit the pooling plan to producers no later than August 1, 1994, for their approval or disapproval in a statewide referendum.

Each producer shall have one vote and the vote shall be individually cast in order to prevent block voting. The director shall prepare a ballot. The ballot form shall be substantially as follows:

Ballot

Shall the proposed pooling plan be made effective? Yes No

In addition, the ballot shall include a statement of the voter's total production during the calendar month next preceding the month of the commencement of the referendum period, where and to whom that production was sold or otherwise disposed, and the producer's name and address.

The referendum shall be set for a period of 60 days. The director may extend the referendum for a period not to exceed 30 days.

The director may reveal the names of producers whose votes have been received to both proponents and opponents of the plan. However, the approval or disapproval of individual producers voting in the referendum shall be kept confidential.

62753. If the director finds that producers on a statewide basis have assented in writing to the proposed pooling plan submitted to them for assent, the director shall implement the proposed pooling plan. The director shall find that producers have assented to the plan if the director finds on a statewide basis that not less than 51 percent of the total number of eligible producers in the state have voted in the referendum and finds one of the following:

(a) Sixty-five percent or more of the total number of eligible producers who voted in the referendum and who produced 51 percent or more of the total amount of fluid milk produced in the state during the calendar month next preceding the month of the commencement of the referendum period by all producers who

voted in the referendum, approve the plan.

(b) Fifty-one percent or more of the total number of eligible producers who voted in the referendum and who produced 65 percent or more of the total amount of fluid milk produced in the state during the calendar month next preceding the month of the commencement of the referendum period by all producers who voted in the referendum, approve the plan.

If the plan is not approved, the director shall continue in operation the pooling plan in effect on the date the referendum was commenced.

BILL NUMBER: AB 1285 ENROLLED 08/19/94
BILL TEXT

PASSED THE ASSEMBLY AUGUST 19, 1994
PASSED THE SENATE AUGUST 12, 1994
AMENDED IN SENATE JUNE 23, 1994
AMENDED IN SENATE JUNE 13, 1994
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AMENDED IN SENATE JULY 6, 1993
AMENDED IN ASSEMBLY MAY 27, 1993
AMENDED IN ASSEMBLY MAY 3, 1993
AMENDED IN ASSEMBLY APRIL 12, 1993

INTRODUCED BY Assembly Members Cannella, Costa, Jones, and Seastrand

MARCH 3, 1993

An act to amend Section 62750 of, to add Sections 62062.1, 62752, 62753, 62754, 62755, and 62756 to, and to repeal and add Section 62751 of, the Food and Agricultural Code, relating to food.

LEGISLATIVE COUNSEL'S DIGEST

AB 1285, Cannella. Milk: pooling referendum.

Existing law provides for stabilization and marketing plans pursuant to which the Secretary of Food and Agriculture establishes minimum prices to be paid by handlers to producers for market milk. Until January 1, 1995, existing law also requires that producers be paid a specified amount for market milk.

This bill would delete the termination date of January 1, 1995, and instead continue in effect those provisions establishing a specified price for market milk until producers vote in a referendum to suspend them. The bill would require the secretary to hold public hearings for the purpose of considering whether to hold the referendum. The bill would require the secretary, following the hearing, to submit a ballot to producers in a statewide election, and would specify the procedures to be followed in conducting the referendum. If existing law is not continued in effect, the bill would require the secretary to continue in operation the pooling plan in effect on December 31, 1993. The bill would also require the statewide weighted average minimum price level for class 1 milk to bear a reasonable relationship to class 1 milk prices paid to producers in contiguous states.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 62062.1 is added to the Food and Agricultural Code, to read:

62062.1. Any designation of a class 1 price by any method or formula that is used to develop class 1 prices paid to producers in the various marketing areas, shall provide, on a

calendar year basis, a statewide weighted average minimum price level for a hundred weight of milk testing 3.5 fat and 8.7 solids not fat that is in reasonable relationship with minimum class 1 milk prices paid to producers in contiguous states. If the statewide weighted average class 1 prices paid to producers are not in a reasonable relationship with the class 1 prices paid to producers in contiguous states, the secretary shall immediately hold a hearing to consider adjustments to the class 1 prices.

SEC. 1.5. Section 62750 of the Food and Agricultural Code is amended to read:

62750. Notwithstanding any provision of Chapter 3 (commencing with Section 62700) in conflict with this section or any pooling plan for market milk in effect under that chapter, effective January 1, 1994, each producer shall be paid the amounts determined in accordance with this section for his or her pool quota production and for all production in excess of his or her pool quota.

(a) For all milk fat, whether or not equal to his or her pool quota, an amount determined by dividing the value of all milk fat in the pool by the amount of milk fat produced.

(b) Transportation allowances that are provided for in the pooling plan shall not be deducted from the quota milk of any region, but shall be deducted from the total solids not fat pool revenue before any price is determined for quota and nonquota solids not fat.

(c) Regional quota adjusters shall continue to be subtracted from the quota price in the established areas as specified in the pooling plan for market milk. However, the hundredweight price specified shall be converted to a solids not fat equivalent value, and the adjustments for the effect of those regional quota adjusters shall be applied to the solids not fat revenue.

(d) After taking into consideration the effect of the regional quota adjusters, the solids not fat announced quota price for those areas in which there is no regional quota adjuster shall be nineteen and one-half cents ($0.195) per pound greater than the announced solids not fat price for all milk produced in excess of pool quota.

SEC. 2. Section 62751 of the Food and Agricultural Code is repealed.

SEC. 3. Section 62751 is added to the Food and Agricultural Code, to read:

62751. Except as provided in Section 62756, this chapter shall remain operative until the secretary certifies to the Secretary of State that producers have voted in a referendum to suspend the operation of this chapter.

SEC. 4. Section 62752 is added to the Food and Agricultural Code, to read:

62752. The secretary may hold a public hearing at any time to consider whether this chapter shall be suspended, and shall hold a public hearing to review a petition requesting the suspension of this chapter signed by not less than 25 percent of the producers who produced not less than 25 percent of the total amount of fluid milk produced in this state during the preceding calendar month.

SEC. 5. Section 62753 is added to the Food and Agricultural Code, to read:

62753. The secretary shall establish a period of 60 days in which to conduct the referendum. The secretary may extend the

referendum period an additional 30 days if he or she determines that the additional time is needed to adequately conduct the referendum, and may prescribe additional procedures necessary to conduct the referendum.

SEC. 6. Section 62754 is added to the Food and Agricultural Code, to read:

62754. (a) Each producer shall have one vote and the vote shall be individually cast in order to prevent block voting. The secretary shall prepare a ballot. The ballot form shall be substantially as follows:

Ballot

Shall Chapter 3.5 (commencing with Section 62750) of Part 3 of Division 21 of the Food and Agricultural Code be continued in effect? Yes No

(b) In addition, the ballot shall include a statement of the voter's total production during the calendar month next preceding the month of the commencement of the referendum period, where and to whom that production was sold or otherwise disposed, and the producer's name and address and pooling numbers.

SEC. 7. Section 62755 is added to the Food and Agricultural Code, to read:

62755. (a) The secretary shall find that producers have assented to the continued operation of this chapter if the secretary finds on a statewide basis that not less than 51 percent of the total number of eligible producers in the state have voted in the referendum and that 51 percent or more of the total number of eligible producers who voted in the referendum and who produced 51 percent or more of the total amount of fluid milk produced in the state during the calendar month next preceding the month of the commencement of the referendum period by all producers who voted in the referendum, approve the continued operation of this chapter.

(b) If the secretary finds that a vote favorable to the continued operation of this chapter has not been given, the secretary shall so certify to the Secretary of State and shall declare this chapter inoperative.

(c) The secretary may reveal the names of producers whose votes have been received to both proponents and opponents of the continued operation of this chapter. However, whether individual producers voted for or against the continued operation of this chapter shall be kept confidential.

SEC. 8. Section 62756 is added to the Food and Agricultural Code, to read:

62756. (a) If the continued operation of this chapter is not approved, the secretary shall continue in operation the pooling plan in effect on December 31, 1993.

(b) Notwithstanding Section 62751, this section shall remain operative notwithstanding a vote by producers to suspend the operation of this chapter.