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From: Andy Keeter [mailto:Andykeeter@email.msn.com]
Sent: Tuesday, January 09, 2001 12:19 PM
To: Brenner, Connie
Subject: Proposed Rule re: Dairy - Docket No. AO-14-A69

USDA
OALJ/HCO

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Dear Ms Brenner,

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I don't know if you are one of the appropriate individuals to respond to. If not I apologize and hope you will forward this to more appropriate individuals.

I am a veterinarian and the managing partner in a 21/2 year old 1600 cow dairy in S.W. Kansas.

Having read the most recent publication issued by the Dept. of Agriculture released December 7, 2000, concerning the proposed rule changes affecting the Dairy Industry (Docket No. AO-14-A69, et al.: DA-00-03), I am disappointed and perplexed by the end results. The objective of the entire debate and resulting rules are to establish a fair pay price to dairy producers by establishing pricing formulas and make allowances implemented and used by processors.

This debate and document generated or reaffirmed several questionable conclusions:

1. Dairy Producers are small businesses if they produce 326,000 lbs. per month, and these programs are tailored to this group of producers.
2. Price Data should be used to generate prices paid to producers.
3. Retail Prices are assumed to "respond penny for penny to changes in milk cost"
4. Dairy Manufacturing plants should be allowed a guaranteed margin (make allowance) to insure stability of markets.
5. Dairy Producers cannot be allowed a make allowance since such an allowance "ignores changes in demand for milk or milk products".
6. "One of the reasons for the success of the Federal Milk Order Program is that all producers benefit through assistance in developing steady, dependable markets, reducing price instability and unnecessary price fluctuations, and assurances of a minimum price for their milk."

As far as producers are concerned, very little changes were made or suggested. After reflecting on a years worth of data reflecting changes in milk pricing and federal order structure, it seems ludicrous to conclude that the only correction necessary is to adjust the protein and fat formula and tweak make allowances. There appears to be a fairly large gap between objective and result - much as a result of poor assumptions and erroneous conclusions.

1. Dairy Producers selling less than 326,000 lbs. per month may compromise the majority of farms in the U.S, however this does not represent the majority of the milk sold. More importantly, is it even appropriate not to identify one sector and imply that they are the group in greatest need of protection. However, if the true objective is to insure the preservation of the small dairy producers in the U.S., then the recommended and established pricing formulas certainly need to be reviewed.

2. On the surface, it seems difficult to argue that Price Data should be used to generate pay prices. However, the source of this Data is very debatable. NASS vs CME is really a mute point. It does appear the argument made and rejected by Western States Dairy Producers Trade Association is true - the use of NASS predisposed to price setting rather than price discovery. There is essentially no difference between NASS and CME - only a difference in time of discovery. The argument against the CME is valid, in that it reflects such a miniscule portion of product. The first week of January, CME reported only eleven 44,000-lb. carloads of cheese sold. This is not atypical, but represents less than 1% of cheese produced, and less than 0.25% of milk sold. However the NASS survey of prices used to determine producer pay prices tend to follow these commodity prices. The wholesale delivered prices reported by Dairy Market News for 40# cheddar cheese blocks for the same time period were \$1.27-2.115 per lb compared to \$1.09 commodity prices. Yet we use the poorly traded block cheese commodity prices to determine producer pay price.

3. Retail prices may "respond penny for penny", but it is not to producer pay price. There may be a correlation to wholesale prices, but if retail cheese correlated to producer pay prices we should be seeing less than \$2.50/lb cheese in consumer markets.

4. If it is appropriate that manufacturing plants have a mechanism to insure long term stability and guaranteed margins, then is it appropriate for manufacturing plants to have influence in establishing price. Producers are paid based off the price of a commodity that is never or rarely sold at the retail level. Block and barrel cheese seems to only trade hands between manufactures, implying that manufacturers do have an influence in price setting - especially when the percentage traded is very low. There is nowhere near enough volume traded to believe the industry is hedging.

It appears to be accurate that the price of cheese at CME was being supported by DFA in July and August, until they ran out of storage for this purchased cheese. Manufacturing provides a large portion of DFA revenue, and only the manufacturing arm could have handled these purchases. Should 1 entity be able to influence the price of a commodity? Why would DFA have an interest in supporting the price at CME if CME prices were not directly correlated to NASS.

It seems that if 99% of cheese is not traded, then it must be contracted. If wholesale prices are significantly higher than commodity prices and they represent over 99% of the market, then should not they too be reflected producer pay price.

If NASS survey of prices is anything like NASS surveys of animal numbers and production levels, then the degree of accuracy is nothing more than a random event. These prices do have a high correlation with the CME but a very low correlation with wholesale prices. I am surveyed monthly about my animal numbers and production, sometimes at my home, and am asked to answer to the "best of my ability" - not accurately.

Accurate or not, the current pricing system breeds resentment between milk handlers and producers. We debate over issues that benefit "us" or "them", not "us and them and the consumer".

5. It seems true that a make allowance would not provide adequate incentive for producers to decrease production in a supply market. However, there is not now, nor has there ever been an incentive for producers to reduce production. However too, there is not now, nor has there ever been a

pricing structure to reflect true supply and demand. Under the current formula, a commodity based pricing formula does what it needs to do in a demand market- as commodity demand increases, then milk prices soar and producers correctly respond by producing more milk. In a supply market, such as we have today, then price plummets to a point that no producer can afford to reduce production. Case in point - heifer sales increased rather dramatically after the release of the recent government support check, implying that producers are looking for ways to increase production in a down market.

Unfortunately, what we are seeing today as a supply market, does not bear out on the retail level as reflected in wholesale prices. It appears that the U.S. dairy producer will produce 6 billion lbs. more milk in 2000 compared to 1999 (~168 billion lbs. compared to 162 billion lbs.). But they will receive ~ \$3 billion less. (\$20 billion v \$23 billion). In essence, U.S. dairy producers paid \$0.50 per lb. to produce the extra 6 billion lbs. of milk. In the last 12 months, it appears that butter and cheese stores declined slightly. Over the last 24 months, cheese stores increased 130 million lbs. - 1.3 billion lbs. of milk. Butter has decreased 3 million lbs. It is true that producers sold more milk than necessary last year, however this was not due to decreasing demand. In 1998 the market was demanding that producers make more milk, yet because they increased production 3.5% instead of 2.5% they were penalized 3 billion dollars.

6. "One of the reasons for the success of the Federal Milk Order Program is that all producers benefit through assistance in developing steady, dependable markets, reducing price instability and unnecessary price fluctuations, and assurances of a minimum price for their milk."

This is an incredible statement!.

The past two years have demonstrated the most unstable prices with the most severe fluctuations the dairy industry has ever seen. Retail markets predominate in the eastern U.S., however manufacturing is rapidly moving west.

The FMO program is successful because it prevents preferential treatment. However, judging from the last several years, it hasn't stabilized markets nor prevented price instability.

If the objective is to preserve the small U.S. dairy producer, the mission is failing. Small producers are diving into financial ruin faster than any other producer sector. N.E. manufacturing plants are closing down, not because they can't compete, but because they have no milk to fill their plants. If the objective is to insure a fair price, then prices should reflect retail prices or at least true wholesale prices - not the value of the last pound of milk produced.

The 81 page document I read referenced testimony from several dairy industry sources - none of whom did not represent manufacturing. Many of the agencies that did testify had members that represented producers, but all had manufacturing members and many had retail members as well. All of the debate presented that appeared to represent producer concern was eventually discarded. Almost all states have producer dairy associations that represent only dairy producers. Are these groups asked to participate in debate?

If this is the method for determining producer pay prices, the federal support prices can never end. Producer pay prices have been below breakeven for 13 months for most producers. No producer can afford to decrease production in hopes of increasing overall income. Most lenders are demanding that producers maintain maximum production and herd number to insure their collateral. Dairy farms going out of business are doing so out of necessity to preserve the last bit of their equity, not because they are ready to retire. Farms are not being sold, they are being mothballed. It is highly unlikely that a small farm will ever reopen. The rules in place today act not to preserve the small family farm, but to accelerate their demise. The stated and unstated objectives for U.S. agriculture and for the food supply of the American public are by and large indisputable. We all want a safe and cheap food supply. However there is something inherently wrong when producers receive \$3 billion dollars less for increased production and consumer prices and demand don't decline.

I hope the premise is true that agriculture and family farms in particular are a valuable commodity in the U.S. If so, then producers need a mechanism to control their own destiny. We have no influence on our price, and only a moderate amount on our cost of production. We have no incentive to decrease production in a supply market. If production costs increase due to labor, energy, taxes, then the mechanism is in place for processors to compensate themselves via make allowances, however producers pay for this, as well as their own increased costs.

We spend way too much time debating the wrong issue in the context of helping the producer. Science can dictate the proportional value of fat and protein at a given price. Producers don't care if processors receive a make allowance if producer prices are fair - however one shouldn't depend on the other. Market demand should dictate price, but it should be overall retail demand - not commodity trading. Dairy production more than any other sector of agriculture operates at the highest level of momentum. It is hard to increase production rapidly and, without incentive, it is almost impossible to justify decreasing production. Our livelihood depends on the demise of somebody else. Today we are waiting for somebody else to have a weather related catastrophe or suffer financial ruin.

A Proposal:

Supply management has been debated for years without ever resulting in a viable program, but producers do need some incentive to reduce production. There is not a producer in this country who couldn't eliminate 1-2% production overnight if it made economic sense. The federal price support seems to be an arbitrary number today that is well below most producers (especially the small producer) breakeven. It appears that the necessary components for a producer influenced supply control / price control system is in place today.

1. Continue to use (and debate) the current pricing formulas and make allowances to set producer pay prices.
2. Use the current NASS survey mechanism and add one additional question: "Where should Class III price be today"
3. Weight this answer with production levels and establish a "strike" price that only affects producers. This creates a dynamic and more accurate cost of production level!
4. When market price falls below this "strike" price, then limit producers saleable milk to no more than 100-102% of prior production levels.

Producers producing 105% of set production levels are only paid for 102% of their production. The excess 3% is paid into the pool, but not disbursed to producers / coops.

Prices set too high penalize growth, not retail prices. Producers that are viable at lower price levels have to decide whether to continue on at a penalty waiting for others to compensate (much like today) or back off and just generate higher margins. These producers will compensate by voting to lower the "strike" price to avoid the penalty.

Prices set lower than Class III will fuel expansion and growth until the "strike" price is increased.

Example: At a \$12.00 Class III strike price, \$11.80 Class III and \$13.50 blend -

Dairy A produces 101% of prior production and receives \$13.50 for all milk sold.

Dairy B produces 105% of prior production and receives \$13.11 for all milk sold. ($\$13.50 \times 102\% / 105\%$). Dairy B is now at a competitive disadvantage relative to A and has individual incentive to lower production.

5. Utilize the Federal Milk Marketing Administrator to administer the program. They already account for monthly individual producer milk sales.
6. Dollars collected for excess production and not paid should be used to fund the program, defer promotion costs, or fund new research.

California may shrug their shoulders at this idea since they don't have to participate or have their vote counted. So refund 30% of excess sales back to Class III handlers in federal order plants giving them a competitive advantage over California plants. Let markets forces dictate supply and demand!

Producers don't want to rely on the next government check, or wait for the next farm bill in hopes that price instability and market fluctuations will be abated.

Sincerely,

Andy Keeter, DVM, MPVM
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