Meadow Gold Dairies

Testimony by: Glenn Muranaka
SB 2956sd1: Relating to Milk
Thursday, Feb. 21, 2008
Sen WAM, 9:30 am
Conference Room 211

Position: Comments

Chair Baker and Members of the Senate WAM Committee:

I am Glenn Muranaka, President and General Manager of Meadow Gold Dairies. Meadow Gold, a member of Hawai'i's' agriculture community for more than 100 years, has always supported Hawaii's diversified agriculture and believed in its future as an industry that had the potential to synergistically combine the benefits of our unsurpassed climate, the incredible global strength of the Hawai'i brand, and technological innovations to grow beyond the unsustainable plantation agriculture and protected dairy industry of our past. In investing many millions of dollars in its farms that once were on the islands of Kaua'i and O'ahu, its plants and distributions facilities on Kaua'i, Maui, O'ahu, and Hawai'i, and in its distributors and employees on all of the islands, Meadow Gold has placed its future squarely within these beliefs. From this experience and history, Meadow Gold offers its thoughts on this proposed legislation.

Observation #1: History

1. We believe that it is important to understand the history of the dairy industry in Hawai'i in order to properly evaluate SB 2956. Otherwise, legislation offered to help may have the unintended consequence of further weakening an industry already impaired by misguided efforts to prop it up in the face of competition and new technological developments.

   By 1988, Hawaii dairy producers had approximately three years to digest its first competition from dairy producers outside the state. This was a result of US District Court's decision in *Safeway Stores Inc.v. Board of Agriculture of the State of Hawaii, et al,* 590 F.SUPP.778 (USDC Hawaii 1984)

   Soon after this decision in 1984, Safeway began importing milk from its San Leandro plant into its stores in Hawaii. Subsequently, other importers followed. Today, there are more than 8 importers of milk into Hawai'i,

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representing more than 11different brands. Competition at the retail level for sales of fluid milk has never been more intense than at present. Incidentally, it is likely that in the days of your youth, the majority of ice cream products in dairy cases in Hawai'i were made in Hawai'i. As with fluid milk today, competition from mainland makers of ice cream products was fierce and, you can now seek in the dairy cases the winners of that struggle. The ice cream history lesson teaches that technological innovation, marketing and brand strengths, and competitive advantageous production and processing facilities will pose formidable challenges to dairy products that rely only on geographical proximity.

2. As with local ice cream, local fluid milk is produced geographically closer to Hawai'i consumer than the mainland fluid product. This advantage, however, has not since 1984 translated into the proposition that local milk is better, safer, or more nutritious than fluid milk from the mainland. With all due respect, the sloganeering that local milk is better, safer, or more nutritious is not a credible or reasoned argument and certainly not one that has been accepted by the majority of consumers in Hawai'i.

3. In fact if not by express admission, by 1988 dairy producers in Hawai'i had abandoned approaches to distinguish their product qualitatively from mainland-imported milk with the exception of the "Island Fresh" milk seal program, which was based on the seeming advantage bestowed by geographical proximity. In other words, "Island Fresh" is "better" because it is "fresher." Unable to identify accepted standards of quality by which their products surpassed mainland milk, the producers argued that local milk had a longer shelf life because it had a shorter, quicker line from the cow to the shelf. However, this marketing campaign was not successful, and to the degree that the producers had an argument, technology arrived in the 1990s in the form of advances in fluid tankers to obliterate that contention.

   Retreating or abandoning unpersuasive "freshness" claims, by or soon after 1988, local dairy producers did not even seek to compete favorably with mainland producers on price. Instead, Hawai'i producers successfully convinced the BOA to set Class I price at the price paid to California producers plus the transportation costs from California to Hawai'i plus an added premium of $3.00 cwt for Oahu producers. From this point forward, local producers bestowed no cost or price advantage on their fluid milk products.

Observation #2: Class I and Class II Price Tiers

1. From the inception of the regulatory framework in the Hawai'i Milk Control Law, the concept of Class I and Class II price tiers based on actual usage have been wisely embedded in the regulatory structure of the local dairy industry.

2. It is wise because price based on use encourages the production of more milk than can be used as Class I thereby rewarding producers who produce without penalizing producers who failed to produce to quota.

3. It wisely encourages a processor to accept as much milk as a producer can produce because the processor could use excess processing capacity to make or develop a third party market for others to make products such as ice cream, yogurt, ice cream mix, sour cream, cottage cheese, and other non-fluid products which use non-class 1 fluid milk. These products could be made with fluid milk which had a Class II cost, but almost never could be made with a fluid milk priced at Class I. At a Class I price, users would simply elect to use less costly equivalents such as lard or skim powder.

4. Class II pricing frequently is created when skim milk is made for the DOE schools, which currently serve skim milk. This requires the removal of fat from the dairy producer's whole milk delivered to the processor. Skim milk production thereby results in surplus fat which is primarily utilized in products such as ice cream mix or yogurt products which use the excess fat in lieu of alternative ingredients such as lard and skim powder. This is possible because the Class II cost often makes the excess fat the ingredient of choice when a Class I cost would make the excess fat uncompetitive.

   The use of fat from skim milk for ice cream mix has created a market for the dairy producer, which results in a payment that would not exist if such fat were not sold. This is the current Class II market. It would be substantially reduced and perhaps destroyed if the Class II price was equal to the Class I price.

5. It discouraged dump of milk because a processor who is forced to pay Class I prices for milk that cannot be sold or used for Class I purposes will not accept milk and cannot accept milk for which there is no Class 1 market.

Insistence on paying Class I prices for such milk will only lead to an increase in returns from the market and assignment of such returns to the excess pool wherein no producer receives payment. In other words, a processor cannot buy more milk than can be sold. If a processor is compelled to pay Class I for milk that will end up in a Class II usage, the processor will not buy the milk. The producer who produces in excess of Class I usage will end up with that milk dumped.

Observation #3: Quota System Changes Proposed in SB 2956

1. Rather than tinker with the Quota System, it is recommended that discussion occur about the purpose and continued use of the Quota System.

2. The Quota System limits the production of milk to holders of the quota.

3. For a new producer to enter the milk shed, quota must be obtained. Historically, the only way to obtain quota was to buy it from an existing holder of the quota.

4. Consideration should be given to ending the Quota System so that potential dairy producers do not have to buy or acquire Quota to become a producer in the State of Hawai'i. It is a cost and it restricts production.

Observation # 4: Thoughts On What Can Be Done

1. It has been frustrating to see the decline of this local industry. We believe that a long-term perspective shows that regulations and legislation that protect from competition usually result in weak producers who rely on short-term boosts to income through increases in prices rather than investments in infrastructure, technology, and brand development.

2. Production must be competitive. This means that land and infrastructure must be merged. The land holdings must be large so as to allow the development of the needed size and type of infrastructure needed to compete in a global economy. This strongly implies a Neighbor Island base given the urbanization of O'ahu.

3. Technology must be adopted quickly. Cooling, refrigeration, shipment, and delivery technologies are rapidly evolving. Competition demands nimble use of technology. The location of production facilities on a Neighbor Island underscores these needs.

4. Branding and marketing must be taken to new levels of competence and application. Private enterprise is good at these tasks. After all, it is a matter of survival in the private sector.

   The best way to ensure that IAL and water systems remain dedicated to agriculture is to ensure commercial success of farmers. This assurance can be done through the development of an agriculture marketing entity, perhaps through ADC, that would primarily market Hawaii fresh produce and meats to state institutions (DOE, Public Safety, Hawaii Health Systems Corporation, etc). As a secondary market, the entity would also market to local outlets that want to support a sustainable agricultural industry.

   In addition, the Seal of Quality program can be marketed more aggressively to residents who want to support a sustainable agriculture industry. The Hawaii Marketing Alliance, of which I am Chairman, initially developed the Seal of Quality brand and is comprised of agriculture leader-experts in brand building. The proposed marketing entity (ADC) could sub-contract with the HMA to accomplish that.

Thank you for the opportunity to present comment and testimony.

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TESTIMONY OF SANDRA LEE KUNIMOTO
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BEFORE THE SENATE COMMITTEE ON WAYS AND MEANS
THURSDAY, FEBRUARY 21, 2008
9:30 A.M.

SENATE BILL NO. 2956 S.D. 1
RELATING TO MILK

Chairperson Baker and Members of the Committee:

Thank you for the opportunity to provide testimony on Senate Bill No. 2956 S.D.1, relating to milk. The Milk Control Act regulates the assignment of milk quota and the minimum price paid to the local milk producers. A Class I price is paid to a producer by the State's only milk processor when milk is utilized for fluid consumption. The lower Class II price is paid when milk is utilized by the processor for other non-fluid dairy products, such as yogurt and cottage cheese. The Class II price is approximately 2/3rds of the price paid for Class I milk. The department strongly supports this Administration bill.

Currently, there is no control over the amount or source of milk utilized for Class I or Class II milk by the processor and no alternative processor in the State. In 2007, locally produced milk represented approximately 18% of the total milk and milk products consumed in the State and the other 82% came from imports into the State. The majority of the imported milk is pasteurized on the mainland, transported in insulated rather than mechanically refrigerated, bulk containers and re-pasteurized before being packaged by the local processor. Imported milk may have been in transit from the farm for close to two weeks and will have traveled over 3,000 miles before arriving in Hawaii stores.

This amendment will help to ensure that 100% of the local producers' milk produced within their quota will be used for fluid consumption rather than for the lower compensated Class II purposes. It will also mean that Hawaii's consumers will obtain fresher milk and will contribute to the continued operation of the two remaining Hawaii dairies.

The department recognizes the challenges facing the dairy industry. The department also recognizes the importance of providing island fresh fluid milk for the consumers in the State. The gathering of Hawaii milk industry stakeholders to discuss critical issues and help identify and recommend short and long term solutions will help to ensure the availability of locally produced fresh milk for fluid consumption.