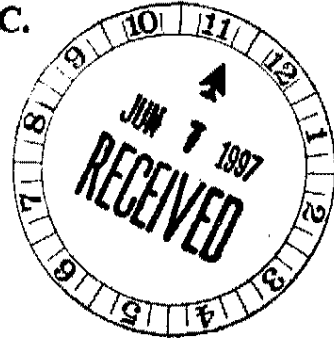




ASSOCIATED MILK PRODUCERS, INC.
Southern Region



Fax Cover Sheet

DATE: 6-7-97 TIME: _____

TO: Rick McKee FAX #: 202-690-3410

COMPANY: Dairy Div - USDA

FROM: **AMY CLAPPER** FAX #: **817-548-5201**

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Number of pages including cover sheet: 26

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ASSOCIATED MILK PRODUCERS, INC.
Southern Region

June 6, 1997

Mr. Richard McKee
Director, Dairy Division
Agricultural Marketing Service
United States Department of Agriculture
PO Box 96458
Washington, DC 20090-6456

RE: Comments to Committee Reports Released under the FAIR Act

Dear Mr. McKee:

The following outlines the general scope of federal order reform supported by Associated Milk Producers - Southern Region, with respect to the federal order reform process as legislated by the 1996 Federal Agricultural and Improvement and Reform Act (FAIR).

AMPI - Southern Region

Southern Region is owned by approximately 2,500 member producers whose annual output exceeds 6 billion pounds. Membership is spread across twelve states and pools under the requirements of five federal orders. AMPI makes up approximately 10% of the Southern Illinois/Eastern Missouri Order, 35% of Southwest Plains, 10% of the Southeast, 50% of Texas, and 65% of the West Texas/New Mexico orders.

AMPI supports the continuation of Federal Order programs. AMPI believes in the underlying purpose of the federal order system as enacted by the Agricultural Marketing Agreement Act of 1937 (the "1937 Act"). The 1937 Act specifically calls for the Secretary to fix minimum prices to be paid to producers that reflect economic conditions of the supply and demand for milk and its

products, and to ensure a level of farm income adequate to maintain productive capacity sufficient to meet future needs. The issues through which the current system came into effect continue to exist today. Perishability of the product, coupled with differing quality standards for classified pricing exists. The supply/demand forces resulting from the system have reached a balance by meeting the needs of consumers and producers under current pricing mechanisms. Americans continue to enjoy the cheapest food supply in the world. Efficient farmers and programs such as federal milk marketing orders have maintained the abundant supplies of fresh milk that we relish in today.

In 1996, congress mandated FAIR which calls for reform of the current order system. The key directives of the 1937 Act must remain the primary source for directing changes within the system. Data compiled through federal order statistical summaries reveal that 83,000 dairy farms are regulated through the federal order system. With only 560 regulated purchasers, owned and operated by an even fewer number of interests, there are clear examples of the inequity in bargaining power for the dairy production unit. Through the continuation of classified pricing structure and uniform blend returns, the distribution of higher valued products is passed through the complete chain of production. This program bodes well as the pricing structure assures an adequate supply of fresh milk for the retail fluid marketplace. As we approach a new century of dairy marketing changes must be made to ensure both preservation and competitiveness of domestic and international dairy markets.

As a producer owned marketing cooperative, AMPI faces the challenge of balancing both membership sustenance and the need to procure profits from fixed assets that are necessary to balance the perishable product we know as milk. The inclement weather under which our members must produce a quality product creates the need for such facilities. Milk produced in the South can easily fluctuate 40% from high to low on a twelve month basis. Such a fluctuation demands balancing in order to provide sufficient supplies for use in the fluid marketplace.

These issues, along with the heightened transportation costs from farm to market in the expanse of the Southwest force these markets to consider the diversity under which milk is produced, transported, and processed. The following comments directly address reports generated by

USDA appointed committees that have been assigned the task of evaluating economic alternatives to provisions now contained in the federal order system.

Price Structure/Classification/Identical Provisions

AMPI supports the continuation of a four tiered classified pricing structure. In order for fluid processing plants to have the ability to attract sufficient supplies necessary for bottled demand, Class I differentials must be maintained. These differentials must not only cover the added costs of producing quality supplies, but must also provide returns for transportation and balancing costs which are extremely high in the southern United States.

Such prices must be zoned within a market to reflect these transportation and balancing costs. Prices must also be properly aligned to alleviate any competitive conditions which may result from improperly aligned values as processors must contend with surrounding markets relating to transportation and procurement costs. As the committee has pointed out, alignment issues are prevalent to geographies in the Southeast, Southwest, and Central market areas.

In the West, milk production is in a growth stage. It is, however, limited to the manufacturing and balancing outlets available to the area. Milk supplies are not always located near the populated areas which increases transporting costs to the market. Additionally, alignment to markets in the East is particularly important so that reserve supplies will be maintained in the most efficient manner.

Texas and Louisiana are pivotal points in balancing reserve supplies to the West and deficit markets to the East. Seasonal swings in production coupled with these balancing needs demand proper pricing levels to maintain adequate production. The range of differential must be incorporated to align markets in both the southernmost areas where milk must travel farther distances from reserve supplies, and also to eastern markets where deficit markets prevail.

Oklahoma, Kansas, and Arkansas must also be aligned with those markets to the south and east. As the relationships to the East and to the North are apparent, such prices must again be constructed so that efficient markets will prevail.

The demand for Class II products has become more inelastic and the need to move parallel with the Class I market continues. AMPI supports upholding differentials by adding a location specific differential for Class I and a flat differential for Class II. The mover should be based on a combined milk price using components as the underlying mover for these products. This mover should be averaged to provide market stability to both the purchasing handlers and for blend returns to producers subject to the order program. By incorporating a three or six month average, market conditions can react to movements in price based on supply/demand factors while smoothing out the Class I and II component of pricing for both the producer and the processor. Such a consequence is required by both sides of the industry in the face of ever-increasing price volatility.

In order to comply with the Act, all milk must be included in the minimum pricing scheme. As reported by the BFP committee, new legislative authority would be needed due to the requirements set forth through the 1937 Act. Additionally, all prior valuations of milk have been computed with an inclusion of all milk price levels creating a precedent which is difficult to exuviate. Therefore, any movement to pooling only those differentials above the Class III level should not be used for pricing producer milk.

Market clearing should be maintained in the order program. The continuation of Class III-A pricing or another method to price components used in the production of nonfat dry milk is necessary.

As in all orders, regional adjustments are necessary to alleviate certain marketing conditions which exist in those areas. AMPI supports provisions which allow federal orders to respond to markets in an efficient manner. This concern is raised when addressing a pooling requirement whereby plants must pool their milk 12 months out of the year. Balancing plants operated by co-ops are managed primarily as such; a balancing function. In most instances, such management practices

do not return positive profits to these entities. Additionally, the existence of such facilities enables the market to cushion Class I pricing levels through forward pricing. This forward pricing requirement should allow balancing plants to seek the most equitable pooling stance for its ownership. As stated above, these plants are necessary to ensure that milk is available to the fluid market.

AMPI concurs with the classification committee suggestion to incorporate market-wide service payments to operators of butter/powder plants. The existence of these operations perform necessary balancing functions within a marketplace. The existence of balancing plants enables all who participate in a market to balance Class I requirements through having a nearby outlet for surplus supplies. Such a market-wide payment is necessary to return level prices to all who participate in areas where wide swings in production dictate the need for balancing. A balancing plant performs to the market by ensuring an outlet for all milk by balancing fluid demands with local production. Demand by fluid processors varies not only on a seasonal basis, but also varies during the week as plant operations normally slow during weekends.

This payment scheme is most equitable, as producers do not balance the market; available plant capacity balances farm production. A monthly stipend paid from the fund to balancing facilities would comply with the provisions set forth in the Act. To "assure a level of farm income adequate to maintain productive capacity to meet anticipated future needs," such payments are necessary for these investors.

AMPI Southern Region owns and operates eight manufacturing facilities located in Hillsboro, Kansas, Mansfield and Mountain View, Missouri, Muenster, Stephenville, Winnsboro, Sulphur Springs, and El Paso, Texas. Plants located at Winnsboro and El Paso are primarily used as a residual balancing function when cheese plant capacity is insufficient for nearby supplies. The following table outlines usage to capacity at these plants for 1996:

Table 1

Capacity Utilization for AMPI Manufacturing Plants CY96

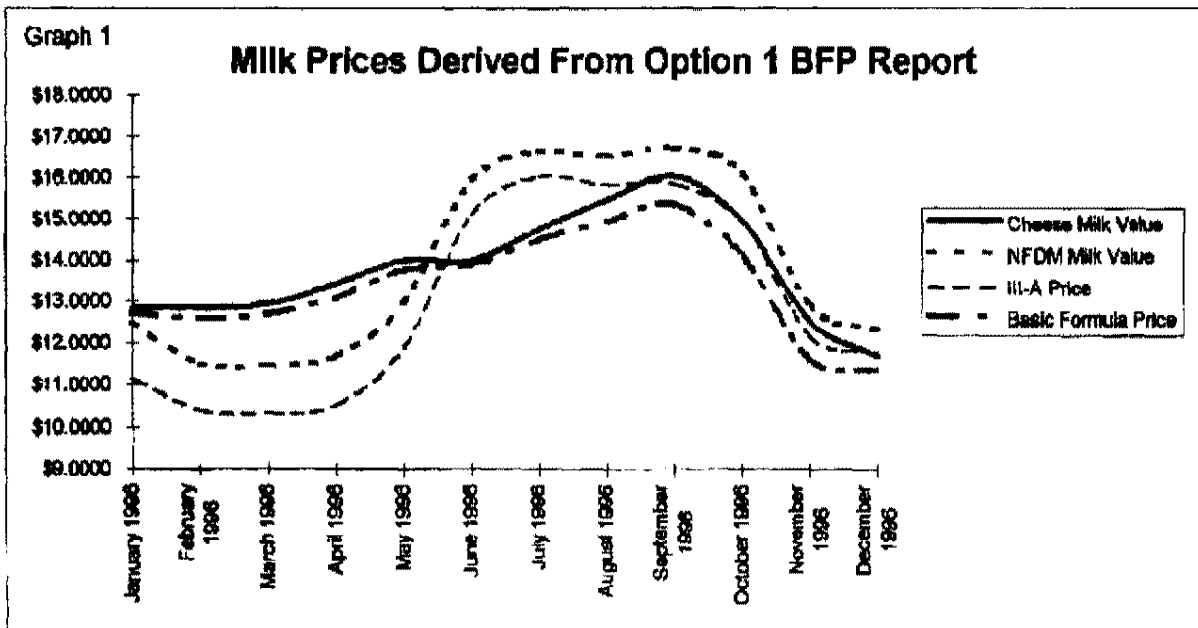
Month	Hillsboro	Mt. View	Mansfield	Muenster	Stephenville	Sulphur Springs	Winnsboro	El Paso
January	51.07	24.12	90.3	105.94	78.55	61.97	101.13	62.34
February	77.09	57.09	92.25	100.18	87.94	61.57	105.67	57.33
March	106.19	97.55	101.99	106.82	93.8	73.2	119.43	77.11
April	101.48	102.23	107.52	106.71	90.88	71.66	111.44	93.69
May	102.28	57.26	115.03	108.86	94.29	70.85	103.55	93.69
June	84.86	33.61	93.68	93.56	77.64	76.78	37.72	33.9
July	62.48	14.13	82.59	87.48	85.86	82.97	21.22	.64
August	59.89	17.26	75.6	48.31	70.8	82.13	5.1	16.04
September	43.49	20.51	64.05	43.85	45.13	82.61	3.55	14.67
October	62.07	29.02	68.71	80.49	67.91	71.73	14.2	29.1
November	60.56	25.13	66.34	90.02	81.72	62.23	26.07	27.76
December	85.76	29.2	79.67	103.32	92.62	63.7	59.53	45.13

These numbers clearly indicate that there is wide fluctuation in the available capacity at not only butter/powder facilities, but also at cheese locations. The high costs of maintaining the availability of this balancing function along with the decreased revenues inherent in running at less than a marginal return make a strong case for a compensatory payment to these plants.

AMPI supports Option I of the BFP Report. This option is revenue positive to the entire pricing system and thus to producer income by about 20 cents per hundredweight. But because AMPI owns and operates market balancing assets it shares in a disproportionate share of the balancing costs and blends down its share of the 20 cents.

Table 2
Milk Prices Derived From Option 1 BFP Report

	Cheese Milk Value	NFDM Milk Value	III-A Price	Basic Formula Price
January 1996	\$12.8493	\$12.4736	\$11.16	\$12.73
February 1996	\$12.8316	\$11.4896	\$10.39	\$12.59
March 1996	\$12.9331	\$11.4719	\$10.32	\$12.70
April 1996	\$13.4224	\$11.6776	\$10.52	\$13.09
May 1996	\$14.0041	\$12.9803	\$11.90	\$13.77
June 1996	\$14.0118	\$15.9570	\$15.12	\$13.92
July 1996	\$14.7452	\$16.6330	\$16.01	\$14.49
August 1996	\$15.4674	\$16.5191	\$15.82	\$14.94
September 1996	\$16.0419	\$16.7236	\$15.85	\$15.37
October 1996	\$14.9900	\$16.0923	\$14.94	\$14.13
November 1996	\$12.5326	\$12.9044	\$12.18	\$11.61
December 1996	\$11.6941	\$12.3232	\$11.75	\$11.34



Plotting price data from Option I of the BFP report and comparing it to capacity utilization data reveals the heart of AMPI's concern. (Milk Prices Derived From Option I BFP Report - Table 2 and Graph 1) All prices are taken from the BFP report. The butter / powder price (BPP) falls below the old BFP for several months in 1996 and exceeds it for several months. The III - A price is always less than the BPP. Obviously profit and loss statements will always be worse using the BPP instead of the III - A price. But in months of heavy usage - January through May - the losses are large. In these months much seasonal market balancing occurs but the cost is borne by only AMPI. The negative impact on the AMPI plant complex is \$4,700,000 using milk values as inputs. If calculated on a MCP basis the loss increases as our component tests are greater than the standards used in the formulas. (AMPI Plant Impact on Milk Valuation By Month Using 1996 as a Base - Table 3)

AMPI Plant Impact on Milk Valuation By Month Using 1996 as Base

@ STANDARD FORMULA - 3.5 % PRICE

Table 3

	Cheese plants		Butter/Powder Plants				
	Milk Volume	Plant Cost Effect Cheese milk	Milk Volume	Plant Cost Effect Butter/powder	Total Volume	Total Plant Cost Effect	Actual Plan Margin
Jan	101,922,034	\$ (121,593)	70,250,476	\$ (857,395)	172,172,510	\$ (978,988)	\$ 476
Feb	112,601,193	(272,044)	73,546,782	(682,692)	186,147,975	\$ (954,736)	1,777
Mar	125,503,379	(292,548)	88,076,459	(888,798)	213,579,838	\$ (1,181,347)	1,501
Apr	124,292,695	(413,149)	90,286,260	(865,526)	214,578,955	\$ (1,278,675)	1,442
May	125,790,219	(294,475)	83,233,312	(780,633)	209,023,531	\$ (1,075,108)	688
June	104,729,121	(96,141)	27,824,688	(233,238)	132,553,809	\$ (329,380)	(515,)
July	97,133,452	(247,885)	7,434,228	(50,865)	104,567,680	\$ (298,749)	(714,)
Aug	74,678,598	(393,855)	42,014	126	74,720,612	\$ (393,729)	(753,)
Sep	55,769,077	(374,712)	470,929	(6,374)	56,240,006	\$ (381,087)	(717,)
Oct	85,763,958	(737,570)	3,050,060	(37,601)	88,814,018	\$ (775,171)	488
Nov	96,323,732	(890,528)	14,684,902	(114,630)	111,208,634	\$ (1,005,158)	371
Dec	115,532,247	(409,100)	42,925,994	(261,006)	158,458,241	\$ (670,106)	576
Ytd	1,220,239,702	\$ (4,543,601)	501,826,104	\$ (4,778,633)	1,722,065,806	\$ (9,322,233)	\$ 4,621

Any gains by the revenue positive effects of Option I for AMPI producers are reduced by the losses in the balancing sector. Without retaining Class III - A pricing in some form or providing for some type of Marketwide Service Payment AMPI producers lose. Certainly a portion of the Class I differential is there to offset the cost of serving the market. This portion should not be shared with producers who do not have the costs.

Other noted provisions addressed in the committee reports include pro-rating shrinkage based on plant utilization. This is appropriate, as plants should account to the pool at a price that is the intended use for milk processed at such facilities. Additionally, handlers need to account for excessive shrink on a pro-rated basis to ensure plant efficiency.

Provisions common to all markets should be scrutinized to the utmost degree. As market geography is defined by the distribution and sales of fluid handlers the suppliers of those markets should be addressed through pooling provisions. Regional variances in production costs, seasonality, balancing issues, and transportation should dictate the make-up of provisions. While both numbers and access to distributing plants diminishes, the need for provisions that will enable pooling within a market must be heard. Producers who are located within a marketing area should have the most access to pool dollars generated from those markets. Conversely, milk located outside the boundary of a market must demonstrate an association to markets outside their production area.

This is true when computing location adjustments for shipments outside a market area. When producers prove a clear association with a market, the right to pool should follow. However, in cases where milk is moved only to share in higher prices, the market then becomes imbalanced. The suggestion to floor all diverted milk at the Class III value could distort the actual market conditions where pooling provisions do not alleviate these problems. Therefore, AMPI feels that pool provisions should incorporate a universal recognition of local supplies with adjustments for regional requirements.

BFP the Essential Element of Federal Order Pricing

A basic element of the Federal Order reform process is the computation of a new basic formula price. The basic formula price (BFP) serves as the price basis for market clearing products, manufacturing products and as the price mover for the added value fluid associated (Class II) and fluid use products (Class I). Each of these product classes have differing consumer demand characteristics and price elasticities. However, the relationship between each product class is clearly definable and follows expected economic principles regarding alternative usage and residual or market clearing practice.

The current BFP and its predecessor the Minnesota - Wisconsin price suffer from their link to Grade B milk. A clear factor in the BFP replacement debate is how to best break this link. While the mechanics underlying either price series are (were) sound the criticism relative to the declining volume of Grade B milk has been valid. Thus a new series must be determined in order for the Federal Order system to function.

Underlying General Principles.

- 1) The BFP replacement should be computed with methodology that is revenue positive to producers.
- 2) The BFP replacement should be computed recognizing that price volatility has become a serious problem for the industry.
- 3) The BFP should remain a nationally uniform price.
- 4) The BFP replacement should be computed recognizing the structural change in the industry resulting in fewer and larger farms will continue.
- 5) The BFP replacement should be computed in a manner that the prices derived by its computation be achievable in the marketplace.

Revenue Effect of the New BFP

The Secretary is required by law to maintain price levels that will assure adequate supplies of milk for consumers. Since cows are not like the widgets of Microeconomics 101 which could be

immediately produced or not produced depending on demand levels a pricing strategy that considers longer term effects must be considered. In our opinion current price levels nor the methodology which derives them will achieve the goal of a long term reliable supply. We urge the Secretary to give adequate consideration to the income needs of producers any new BFP computation and that that computation yield revenue positive effects for producers.

Current price trends will result in some of the very low mailbox prices. Price levels that trend below production costs for extended periods of time damage the production capacity of the industry. The resulting catch-up is slow and can bring some additional unintended negative consequences. (Such as a desire to import manufactured products to fill a temporary shortfall in supply.) A comparison of 1995 Mailbox milk prices and 1995 ERS Cost of Production Data (most recent available) shows that milk prices are well below the cost of production in every region of the country. The negative variance ranges from \$2.84/cwt in the Southern Plains region to \$5.57/cwt in the Northeast region. 1996 Cost of Production data shows increases of over \$2.00/cwt in each region but even so no region would have a mailbox price within \$0.50/cwt of its cost.

Table 4

ERS Cost of Production Data and AMS Mailbox Prices 1995/1996

	Northeast Average	Southeast Average	Upper Midwest Average	Corn Belt Average	Southern Plains Average	Pacific Average	ERS US/FMMO Simple Average
ERS Costs ¹ -1993	\$16.81	\$17.57	\$17.39	\$17.34	\$15.03	\$12.08	\$15.78
ERS Costs - 1994	\$17.68	\$18.16	\$17.60	\$17.91	\$15.51	\$13.20	\$16.49
ERS Costs - 1995	\$17.77	\$18.23	\$16.64	\$17.35	\$14.83	\$12.74	\$15.97
Mailbox Prices ² -1995	\$12.20	\$13.41	\$12.31	\$12.07	\$11.99	\$11.38	\$12.23
Difference between 1995 ERS and FMMO costs	\$5.57	\$4.82	\$4.33	\$5.28	\$2.84	\$1.36	
Mailbox prices - 1996	\$14.30	\$16.24	\$14.36	\$14.26	\$14.18	\$13.52	\$14.48

¹ Milk production regions as defined by ERS

² Federal Order(s) that most closely match the ERS regions. Mailbox price as defined by the Dairy Division.

Certainly some level of revenue enhancement through the BFP would be warranted. Option I of the BFP report does provide a revenue positive effect on milk prices.

The resulting prices generated by the BFP computation process should be uniform nationwide. If regional adjustments are needed for the fine tuning of supply / demand imbalances they are easier made in the Class I differential level. At the BFP level price adjustments affect the entire system not just a sector of the country.

Price Volatility

Price volatility has become a recent but regular aspect of the dairy industry in the past three years. The short supplies which caused the volatile price increases of last fall stemmed in part from the large run up in feed costs in 1995. Dairy farmers exited milk production at rates faster than normal trends and milk production suffered. The BFP reached \$15.37 in September 1996. This compares with peak levels of \$12.91 (12/95) and \$12.99 (04/94) in prior years.

Fluid milk processors are now providing solid documentation of a drop off in fluid milk consumption in the fall of 1996. As demand fell, milk supplies were diverted in to cheese production. However, cheese supplies began to outstrip the demand for cheese and cheese inventories grew to their current record level. The May 19, 1996 issue of Dairy Market News Statistics reveals in the Cold Storage Report for Commercial and Government Storage Holdings that the volume in storage of Natural American Cheese was 423 million pounds. The largest monthly volume reported for 1996 was 398 million in July; in 1995 the peak was 361 million in July; in 1995 the peak was 358 million and in 1994 the peak was 410 million pounds in storage. Cheese prices fell dramatically in response to the combination of increased production and decreased consumption. The BFP dropped from the \$15.37 peak in September to the latest reported \$10.70 in May 1997. Price volatility causes production decisions that may not otherwise be made absent extreme volatility. Some effort must be given in the BFP replacement debate to determine if the mechanical processes that compute the BFP can mitigate volatility without causing long term damage to price signals.

BFP Prices Products That Compete in a National Market

The BFP should be a uniform price nationwide. All manufacturing products compete in a nationwide market in the same shape and form. To have regional different Basic Formula Prices would be unreasonable from the point of view of economic analysis. But most important it would subject the industry to a continual debate about Federal Order provisions and which would result in the demise of the Order program.

Structural Change in the Milk Production Sector

Also affecting the supply demand relationship has been the migration of milk production westward coupled with the relentless trend towards fewer but significantly larger farms. The USDA Milk Production report continues to document the emergence of the Western States as the top milk production areas. In general the report shows that a 30 percent of the top twenty states (the regular reporting method) are from the "west" but produce over 38 percent of the milk. Appendix 8 of the BFP report also details this trend. Eleven of the seventeen states with projected milk production increases for the year 2000 are in the western region. This region is dominated by larger farms. BFP computations that overly stimulate production responses will accelerate the structural change trends ongoing now.

BFP Price Level in Relationship to Market Prices

Finally the price level determined should be market related and represent prices that can be obtained from the market. History continues to demonstrate that dairy farmer owned cooperatives serve as the agents for market clearing and balancing. Until weekends, holidays, school schedules and cow biology are eliminated or greatly modified cooperatives will likely continue to be the market balancing agents. By establishing a market clearing price above that which can be obtained in the market for the resulting manufactured dairy products the owners of the market clearing assets realize losses that are unavoidable. Clearly the make allowances used in the formulations must recognize reasonable manufacturing costs in order to allow the product manufacturers a chance to achieve the returns from the marketplace and pay a reasonable value for milk. AMPI supports continued use of 'standard' make allowance factors. While the other proposals for consideration - audited actual results and 'engineered' costs were outlined no details are available for review. While the 'standard cost' approach is subject to criticism it does provide for an

adequate manufacturing allowance. Note however, even 'standard costs' assumes full use of the manufacturing facilities. In our primary markets all but one of our manufacturing facilities are only used only seasonally. Even in New Mexico seasonal production and sales patterns will cause the shut down of our butter powder plant in the late summer and early fall.

Four Class Market is Necessary

The BFP replacement process should be designed to function in a minimum four class market. Class IV would be used to price butter and NFDM products thus serving as the class for market clearing products. Class III would be used to price other manufactured products, primarily cheese, and serve as the price basis (plus a differential) and price mover for Class I and II.

A three class market does not provide enough differentiation for market clearing and for the principles of added value to function properly. This principle is recognized in the BFP report. (A Preliminary Report On Alternatives to the Basic Formula Price - April 1997 - p40)

The basis for this option comes from the different market demand for selected finished dairy products. Because of the difference in demand for butter / powder and cheese, the prices that manufacturers can obtain from the market also differ. This fact was reflected in the adoption of Class III - A pricing for milk used in nonfat dry milk(NFDM). Regulated pricing can distort the market when pooled handlers must pay the same prices for mil used in NFDM as for milk used in cheese. The market will generally not return a value for the NFDM that covers handlers' costs of buying the milk and drying it. These two surplus uses of mil should be priced differently, with the price used for each class of milk established independently. This approach to pricing milk used in manufactured products allows the market to clear at the lower price. The price of the higher valued use would be able to remain at the higher level justified by market conditions. This enhances returns to dairy farmers beyond the level they would receive if all milk used in manufactured dairy products is priced at the lower market - clearing level. Supporting research (Emmons, 1990) shows that a three class pricing system results in no single pricing formula that is satisfactory for all three product classes.

Computation Preference for the BFP

Our preference for the computation method to be used is Option I of the BFP report. (page 40) That choice outlines a four product class pricing plan and to compute prices for nonfat solids and butterfat used in butter / powder (Class IV), and a second MCP plan to compute prices for protein, butterfat and lactose used in the manufacture of cheese (Class III). Table 5 page 34

indicates that a six year average weighted MCP manufacturing price is revenue positive by \$0.19/cwt.

Multiple Component Pricing

Each price should be broken down into components for funds collection from the marketplace and for funds payment to producers. Excepting that (Class I pricing remain on a skim / fat basis). The process of computing component values from a price series is currently being used in all of the Federal Orders that have Multiple Component Pricing so the technique would be familiar to the industry. Component pricing has been tested in the Federal Order system for many years now and as such the mechanics of the price determination process are considered reliable. Technological advance will increase the demand for products such as concentrated milk. In fact there are sales of this product now. The use of MCP pricing is the only way to accommodate this products such as this. Additionally a MCP pricing plan does recognize component and yield variation in the nations milk supply will acknowledge regional variation in the manufacturing sector of the industry.

We favor a plan that charges producers and handlers at the same rate and that prices at a minimum protein, fat and other solids. This would parallel the plans operational in the Iowa, Nebraska -Western Iowa, Eastern South Dakota, Upper Midwest and Chicago Federal Orders.

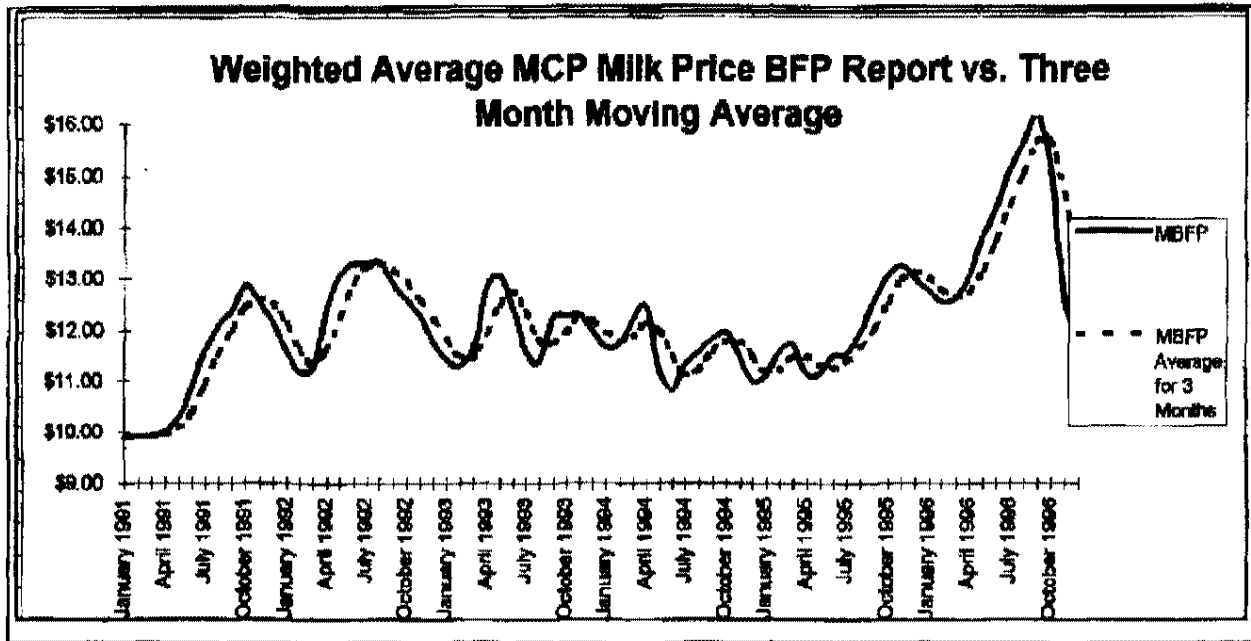
Use of A Moving Average to Set Class I and II Prices

We also would request that some type of averaging process be used convert the BFP (Class III price when used as a price basis and price mover.) into a Class I and II price. Our preference is for a three or six month average to be used. By using an averaging technique the disastrous price drops in Class I and II pricing that occur primarily as inventory adjustments are made in manufacturing product stocks are muted - but not eradicated. However, over a period of time system wide gross revenue would remain similar. We expect that an averaging method would still maintain the linkage between all product markets that we consider vital and necessary but still provide some relief from price volatility.

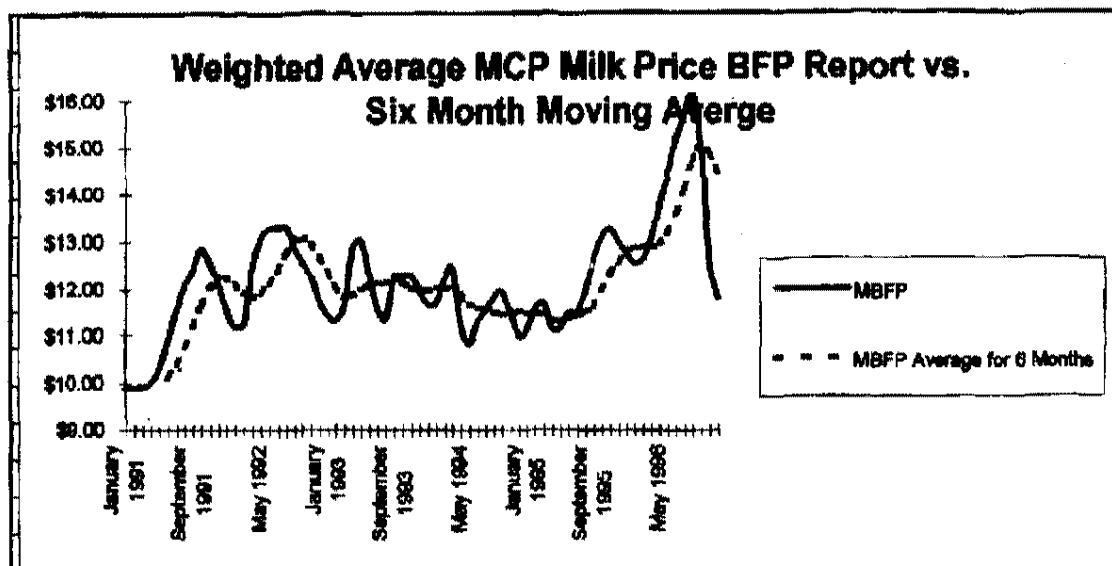
We enclose some computations based from Option I in the BFP report. (The data for these graphs are on page 6.)

These options show the dampening on volatility of using a moving average price. The positive effect is greater using the six month average.

Graph 2



Graph 3



The use of averaging over longer periods of time may affect the relationships of milk supplies to markets. Manufacturing prices will always be more volatile. As such low utilization markets will be affected to a greater extent by the fluctuating level of price. If the averaging mechanism causes a price spread that encourages milk to seek new markets for pooling and revenue enhancement purposes then the averaging period may be too wide. Thus some study needs to be given to insure that any price spreads that result from the use of the averaging technique not become a reason in itself for marketing and pooling decisions.

Our own analysis on the relationship between the Order 30 price and the Order 126 price shows that the return after transport would be - \$2.04/cwt or - \$2.25 under the three and six month scenarios. This computation was done using the three and six month moving averages to compute blend prices. The blend prices were computed using historical utilization percentages only. No consideration was given to changing the pooling status due to changes in price levels. The net difference was reduced by the transport cost - yielding negative returns in every case. The transport cost was calculated by multiplying 956 miles by \$1.72/mile and dividing by 495 hundredweights.

At this point AMPI would favor a six month moving average price. If longer periods of time were to be included in the calculation some type of decaying average might be more appropriate.

Comparison of Blend Prices and Transport Costs

Table 5

	FO 126 Blend Price	FO 126 Blend Price	FO 30 Blend Price	FO 30 Blend Price	Transport Cost	Order 126 Blend Less Order 30 Blend	Order 126 Blend Less Order 30 Blend
	Using	Using	Using	Using		Using	Using
	Option I BFP Report 3 Mo Moving Average	Option I BFP Report 6 Mo Moving Average	Option I BFP Report 3 Mo Moving Average	Option I BFP Report 6 Mo Moving Average	Madison WI to Dallas TX	Option I BFP Report 3 Mo Moving Average	Option I BFP Report 6 Mo Moving Average
Jan-96	\$14.41	\$14.02	\$13.20	\$13.06	\$3.32	\$1.21	\$0.96
Feb-96	\$14.34	\$14.02	\$13.05	\$12.94	\$3.32	\$1.29	\$1.08
Mar-96	\$14.18	\$14.05	\$13.09	\$13.04	\$3.32	\$1.09	\$1.01
Apr-96	\$14.24	\$14.29	\$13.35	\$13.38	\$3.32	\$0.89	\$0.91
May-96	\$14.51	\$14.65	\$13.60	\$13.72	\$3.32	\$0.91	\$0.93
Jun-96	\$14.81	\$14.89	\$14.41	\$14.44	\$3.32	\$0.40	\$0.45
Jul-96	\$15.42	\$15.28	\$15.01	\$14.95	\$3.32	\$0.41	\$0.33
Aug-96	\$16.11	\$15.65	\$15.28	\$15.06	\$3.32	\$0.83	\$0.59
Sep-96	\$16.77	\$16.05	\$16.07	\$15.73	\$3.32	\$0.70	\$0.32
Oct-96	\$17.13	\$16.36	\$15.62	\$15.41	\$3.32	\$1.51	\$0.95
Nov-96	\$16.86	\$16.14	\$13.73	\$13.52	\$3.32	\$3.13	\$2.62
Dec-96	\$15.99	\$15.58	\$13.03	\$12.91	\$3.32	\$2.96	\$2.67
Average	\$15.40	\$15.08	\$14.12	\$14.01	\$3.32	\$1.28	\$1.07

Use Of Cost of Production in Computing the BFP

We continue to encourage the Secretary to consider the use of the Cost of Production as a tool in determining the BFP. The University Study Committee report outlined a method and methodology we feel both relevant and useful. It compared milk prices and feed prices over an extended period of time. If that relationship got out of line an adjustment to milk prices was made until the historical relationship was maintained. The methodology they recommended triggered sparingly. In our opinion had this methodology been in effect in early 1995 the extreme price volatility that began in the second half of 1995 and continues to haunt our market today would have been avoided.

Oppose an Administratively Determined BFP

We very much oppose an administratively set BFP. An administratively set BFP would insure two things - the actual process of setting milk prices will become political as opposed to computational. Secondly, the process of changing prices would no longer function automatically and would begin to lose relationship with supply and demand forces. Third, an administratively determined price will sever the automatic relationship defined by the current BFP pricing process between alternative uses for milk supplies. Over time this would cause disorderly marketing. As prices for various milk usage's diverge milk supplies from lower priced regions would attempt to supplant supplies in deficit areas in order to improve income. This process - when driven by regulation and not supply / demand factors would further aggravate regional conflict over dairy policy.

Oppose Economic Formulas and Futures Driven BFP Computations

We oppose the use of Economic formulas for establishing the BFP. The BFP report outlined many credible reasons for not using them as a price setting mechanism. In addition to those mentioned we would add two others. First they respond poorly to the introduction of new technology to the market or in response to some dramatic shift in market forces. Secondly, they are difficult to amend or revise as conditions change.

We also oppose the use of a futures market driven BFP computation. However, we would like to see AMS regularly publish the CCSE - BFP for industry study.

Class I Pricing

In reviewing the options outlined by the USDA Class I Pricing Committee, only one addresses most of the issues relevant to pricing milk for the fluid market. AMPI supports option 1A as it reflects costs of transporting milk to demand centers across the US. However, the costs of production and balancing do not appear to have been addressed in any of the options outlined by the committee.

Pricing under option 1A creates a revenue negative position for producers located in the South and Southwest. Using the map as provided for these areas, a decline of \$.17/cwt. for Class I milk is the *minimum* impact on producers servicing these areas. The geography and make-up of the order provisions will also impact producer price levels. This pricing scenario creates cause for concern where orders are aligned.

The tiered structure currently in place for Class I levels are in balance. The need for a competitive acknowledgment whereby fluid processors must contend with outside packaged milk moving to a market is in check. This is a major issue when seeking to align both handler prices and producer prices. Nearby markets can cause uneconomic movements when utilization levels return higher prices at the farm.

Such alignment has been addressed through hearings relating to the Texas/New Mexico federal orders and has indicated that the difference from Clovis and San Antonio should be valued at \$1.23. This is the current price alignment, and should be maintained.

Additionally, the price alignment from the northern Texas area to points located south and east has demonstrated proper alignment. As processors packaged distribution moves through the consumer markets proper alignment has allowed competition to exist.

Prices in the Southeast are necessary to cover both balancing and transportation from reserve supply locations. Again, the alignment to the West and North are cause for concern in which market balance can be jeopardized. Intra-order pricing should be reviewed as there have been some problems moving milk from higher production areas to demand centers located in lower priced Class I markets. Specifically, milk produced in the southern Louisiana and Mississippi areas should be recognized by an intra-order transportation value. Also, with the addition of the reserve supplies located in Southern Missouri, the market will achieve a greater degree of balance.

Theories such as relative use and flat differentials do not address the parity price requirement as set forth through the 1937 Act. Such provisions do not provide price levels which will ensure adequate supplies of milk necessary and anticipated for use in the marketplace. Based on the research set forth by the Cornell commissioned study, milk used in Class I products has a different value depending on its location. Thereby negating such pricing theories as outlined in the committee's report.

The criteria used to establish Class I price levels should include all points as outlined by the committee report and should also address balancing needs of the highly volatile production patterns inherent to the southern markets.

Consolidation

AMPI has submitted several comments with respect to the order boundaries. We continue to support those suggestions. As noted, the balancing of markets in which AMPI supplies milk has become a primary influence in the make-up of these markets. The need for reserve supply areas to be associated with the southern geography is necessary.

The southern portion of Missouri and all counties in Arkansas should be included in the Southeast merged market. This inclusion would alleviate the strenuous balancing requirement of the deficit Southeast area. The specific locations outlined by the AMPI proposal would not interfere with packaged route disposition overlap, as suggested by the committee report. Distributing plants located in the Arkansas counties of the current Southwest Plains order exhibit sales distribution

primarily to local markets. The Missouri counties suggested for inclusion do not have any distributing plants located within their boundaries, and would not result in such overlap issues. The final result of incorporating these areas would reduce incentives to move milk inefficiently.

The consolidation of Texas, New Mexico, Arizona, and Oklahoma continues to be supported by both AMPI and United Dairymen of Arizona. There is substantial overlap in sales, procurement, production patterns, and similar cooperative membership in all of these areas. These criteria are parallel with those defined by the consolidation committee and continue as the markets have fewer outlets and larger dairies that supply them. When reviewing the individual make-up of marketplace for both Arizona and Oklahoma there is little overlap in packaged milk sales and procurement *on an individual state basis to any outside markets*. However, when reviewing the data, again on an individual basis, the production patterns are more closely aligned with the markets in the Southwest merger and have overlap in procurement.

Summary

Southern Region presents these comments stressing that the following directives be used in determining federal order policy as we proceed through mandated reforms resulting from the 1996 Federal Agricultural and Improvement Reform Act:

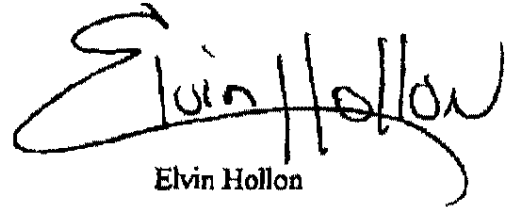
1. The program shall be revenue positive for producers;
2. A four tiered pricing structure, recognizing the market price for cheese and butter/powder products in separate pricing schemes shall be maintained;
3. A multiple component pricing (MCP) plan be adopted to implement the pricing of cheese, powder, and butter, with appropriate make allowances to assure adequate returns to plant investments;
4. A moving average based on a combined MCP price be used as a Class I mover;
5. Option 1A as set forth by the Class I Pricing options report be implemented as the minimum level of Class I differentials throughout the federal order program; and,
6. Market-wide service payments be incorporated into the federal order program so that all producers are responsible for market balancing requirements.

The standards set forth through the 1937 should be the underlying theme for all reform efforts and AMPI believes that these outlined options must be implemented to continue the effort in keeping with the purposes of the federal order program.

Sincerely,



Amy Clapper



Elvin Hollon

cc: Jim Carroll, Region Manager
Richard Fleming, Market Administrator
Don Nicholson, Market Administrator
Sue Mosley, Market Administrator

Appendix -

ERS Order	Federal Order	Order Number
1 - Northeast	Middle Atlantic	4
1 - Northeast	New York-New Jersey	2
2 - Southeast	Florida	6
2 - Southeast	Southeast	7
3 - Upper Midwest	Chicago Regional	30
3 - Upper Midwest	Southern Michigan	40
3 - Upper Midwest	Upper Midwest	68
4 - Corn Belt	Eastern Ohio-Western Pennsylvania	36
4 - Corn Belt	Iowa	79
4 - Corn Belt	Nebraska-Western Iowa	65
4 - Corn Belt	Ohio Valley	33
4 - Corn Belt	S. Illinois - E. Missouri	32
5 - Southern Plains	Texas	126
6 - Pacific	Pacific Northwest	124