The Alliance
of Western Milk Producers

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Office of the Hearing Clerk
USDA
Room 1081, South Building,
1400 Independence Ave., S. W.
Washington, D.C., 20250

SUBJECT: Milk in the Northeast and other Marketing Areas
Docket No. AO-14-A69, et al., DA-003
Alexandria, Virginia
May 8-12, 2000

Dear Sir:

The Alliance of Western Milk Producers is a trade association that represents two major operating cooperatives in California -- California Dairies Inc. and Humboldt Creamery. These organizations represent nearly 50 percent of the milk and milk producers in California. Comments on the above federal order milk marketing hearing are being submitted on their behalf. While California is not part of the federal milk marketing system, what the federal system does has both direct and indirect impacts on California milk producers and the cooperatives they own. That is why the Alliance both attended the hearing and is now submitting this post-hearing brief on the proposals submitted prior to the hearing and the testimony given at the hearing.

Butterfat value

Several proposals were submitted to modify the value of butterfat in the price formulas under consideration at this hearing. The National Milk Producers Federation (NMPF) and the International Dairy Foods Association (IDFA) both proposed lowering the value of butterfat.

NMPF proposed reducing the Class IV butterfat value by six cents a pound. This request is based differences in the butter price used, the make allowance currently used, the transportation adjustment to the CME butter price and the difference in yield factors between the federal and the California systems.

For the period January through June 2000, the NASS butter price has averaged 1.9 cents <u>less</u> than the CME AA butter price. As a result, for the same period, the Class III and Class IV butterfat value averaged just 1.5 cents more than the corresponding California butterfat value. The NMPF proposal calls for lowering the butter make allowance by 1.8 cents per pound of butter. Dividing this reduction by the the butter yield actor of 0.82 essentially wipes out the difference between the butterfat values.

The California adjustment to the CME AA butter price of 4.5 cents is intended to reflect the cost of moving butter to the CME in Chicago. The major butter producing areas of California are over 2100 miles from Chicago. The CME recognizes the cost of getting butter to its market by allowing 4 cents a pound transportation discount on butter located over 1600 miles away. This cost is the approximately the same to move California butter being sold in commercial markets. Over 65 percent of the butter-consuming public is located east of the Mississippi River and over 60 percent of the butter is produced there. To be competitive, the California Department of Food and Agriculture has seen fit to address this competitive disadvantage in part with the transportation credit.

USDA should also take into consideration that at least 27 percent of the NASS butter price is made up of California butter's selling price. Therefore, arguably 1.2 cents of the 4.5 cents is already accounted for in the NASS butter price.

Lowering the value of Class IV butterfat by six cents in addition to adjusting the make allowance will result in a reverse of what NMPF claims to be the current situation. For the first five months of 2000, adopting the NMPF proposal would have lowered the federal order Class IV butterfat price so it would have averaged five cents less than the California butterfat price.

The Class IV butterfat price is only really an issue within Western federal orders. More specifically it has been an issue within the Pacific Northwest order. The Alliance argues that if USDA feels some adjustment is necessary, that rather than lower the butterfat value nationwide (which will likely result in California further adjusting its butterfat value) USDA should consider making regional adjustments as it did with the Class IIIa nonfat powder price previously. This is preferable to any of the adjustments for butterfat values proposed at the hearing.

Nonfat dry milk yield factors and buttermilk

The Western States Dairy Producer Trade Associations proposed changing the yield factor for nonfat dry milk from dividing by 1.02 to dividing by .98. The Alliance is opposed to such a change.

One of the by-products of butter/powder manufacturing is buttermilk powder. As USDA recognized in publishing the final rule, the value of buttermilk powder is significantly less (generally) than that of nonfat dry milk powder.

Alliance analysis of 1999 mostly nonfat powder prices compared to mostly buttermilk prices shows that a yield factor similar to that used in the California Class 4a formula (.99 times the nonfat price less the make allowance) compensates butter/powder manufacturers somewhat for the difference in the relative values of nonfat dry milk powder and buttermilk powder.

A very small quantity of buttermilk powder is produced each year. USDA data shows that in 1999, less than 54 million pounds of buttermilk powder were produced. By comparison, 1.4 billion pounds of nonfat powder and 1.2 billion pounds of dry whey were produced. The quantity of buttermilk powder produced does not justify a separate pricing factor as with dry whey in the Class III formula. The best way to address this is as USDA chose to in the final rule, by adjusting the nonfat powder yield factor.

Costs included in make allowances

There was considerable discussion during the hearing of what costs should or should not be included in the make allowances, particularly for cheese. Considering the price series (NASS) used to determine the value of milk going into cheese, this is somewhat understandable. This is also why USDA-AMS should seriously consider the Western States proposal of using the CME cheese and butter prices instead of NASS prices as the "base" price series in converting product prices into producer milk component prices.

The CME prices for cheese and butter are true *base* prices off of which manufacturers establish market prices for *all* cheese and butter. Selling cheddar cheese or Grade AA butter at the CME is much less costly than selling it in the open marketplace. Prices in the marketplace are all negotiable and in setting those prices, manufacturers include all costs related to doing business including marketing costs and profit. The Alliance would argue that using NASS prices as the base price for pricing Class III and Class IV milk is what has given rise, in part, to the issue of what *costs* should or should not be included in the make allowances for these classes of milk.

Clearly, the CME is a better base price for the Class III formula because processors in all areas of the country have the opportunity to cover their milk and basic manufacturing and marketing costs. Using the NASS prices creates winners and losers – Western processors have to market their way out of a price hole created by use of the U.S. NASS prices and Midwestern processors have a competitive advantage over Western processors because for the U.S. NASS price being used.

The only way to create a more level playing field for processors is to use the CME prices to calculate Class III and IV prices. It will also greatly lower the level of debate regarding what costs the Class III and Class IV make allowances should or should not include.

Another issue using the CME block price as the base price for Class III milk pricing will resolve is what some perceive as the *need* to include the NASS barrel cheese price in the Class III calculation. The CME block price is the basic price off of which over 90 percent of the cheese produced in the U.S. is priced. Only barrel cheddar cheese is not directly priced off of the 40 pound block price, but the barrel price is certainly influenced by the block price. Traditionally (and under the dairy price support program) the barrel price is three cents lower than the block price. However, at certain times during the year, that relationship changes. That is one reason why the National Cheese Institute and IDFA want to reduce the differential added to the barrel price from 3 cents to 1 cent. More importantly, pricing milk using barrel and block prices results in producers being under paid for milk.

Yet another problem with using NASS prices is price transparency. Obviously, the NASS prices follow the CME prices, but they don't follow them exactly or consistently. Throw in the variation in regional price differences along with the NASS time lag and producers and processors are hard pressed to guesstimate what his/her milk price will be.

The USDA should go back to using the CME block cheese price and CME AA butter price for setting Class III and Class IV milk prices:

- Ninety percent of all cheese produced in the U.S. is sold based on the CME block price.
- It is a true base price from which almost all cheese prices are built.

- It is fair to processors because it allows them room to cover costs like plant shrink, under grades, and insurance which the milk producer should not be expected to pay.
- It is fair to producers because it is a real price, not a price that is cobbled together in an attempt to broaden the survey basis to simulate a price.
- Moreover, the CME cash prices relate better to CME future and options prices.

The argument is made that the CME is too "thin" a market. Not much cheese may change hands at the CME, but most of the cheese sold in this country is priced off it. All cheese manufacturers and marketers have a vested interest in an appropriate price at the CME. Concern has also been expressed that it can be manipulated. The fact that trading is carried on daily makes it less susceptible to manipulation than if trading took place just once a week.

It is clear that all parties involved in the dairy products manufacturing industry would benefit from reverting to the CME for manufactured products. However, the USDA should not discard the NASS price survey entirely. The NASS pricing information on whey and nonfat powder is valuable since viable cash markets do not exist. And, NASS block cheese and butter prices should continue to be used to establish Class I and Class II milk component prices. The products that fall into these classes are true added-value products and the cost of milk going into these products should be based on the marketplace value of cheese and butter since manufacturers of these products are the primary suppliers of milk and butterfat to these uses.

Summary

The Alliance of Western Milk Producers is opposed to proposals to adjust the butterfat value used in Class III and Class IV prices as proposed by NMPF and others. Its members believe the nonfat powder yield factor should not be changed due to the buttermilk powder price situation and that the CME block cheese and Grade AA butter prices should be used instead of NASS prices in Class III and Class IV milk component prices.

Respectfully submitted,

Jim Tillison

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