Exhibit NMPF - 6

United States Department of Agriculture
Before The Secretary of Agriculture

In re: [Docket No. 23-J-0067; AMS-DA-23-0031]
Milk in the Northeast and Other Marketing Areas

Hearing beginning August 23, 2023

Testimony Presented By:

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I am Peter Vitaliano, Vice President, Economic Policy and Market Research for the National Milk Producers Federation (NMPF). This testimony is presented in support of Proposal 3, one of five proposals submitted by NMPF. NMPF is the national trade association that represents dairy farmers and the cooperative marketing associations they own and operate throughout the United States. I have been employed by NMPF for almost 38 years as essentially its Chief Economist, in which capacity I have been responsible for all economic and market analysis that supports the programs of NMPF.

NMPF is the voice of America's dairy farmers. Through its 25 dairy marketing cooperative members, NMPF represents two-thirds of the approximately 28,000 commercial dairy farmers in the United States. NMPF's member cooperatives reflect both the geographic and the product mix diversity of the dairy producer and cooperative sectors in the United States. NMPF's member cooperatives process a majority of the Class I milk pooled under Federal Orders and distributed on routes within the 11 Federal Order marketing areas and include one of the largest fluid dairy ESL manufacturers in the United States. NMPF members have significant Class II, Class III and Class IV manufacturing operations and manufacture a majority of U.S.-produced butter and nonfat dried milk products.

Given the diversity and breadth of its membership, NMPF is the dairy industry organization best able to undertake a comprehensive review of the Federal Order system and to weigh its impacts on both dairy farmers as well as processors and manufacturers. NMPF's five proposals presented at this hearing represent a balanced and integrated program of needed and long overdue updates that are in the best interests of the entire U.S. dairy industry and which appropriately balance the economic interests of dairy farmers and dairy plant operators. NMPF strongly supports the Federal Milk Marketing Order program but also believes that the program requires several regulatory and

technical updates to continue to operate in the best interests of dairy farmers, processors and manufacturers of dairy products and the dairy product consuming public.

The current system of Federal Order minimum class prices, which has been in effect since January 1, 2000, is the hybrid product of Federal Order Reform rulemaking and Congressional action. The dairy product price formulas for determining Federal Order Class III and IV prices implemented in January 2000 replaced the Basic Formula Price (BFP), which used a survey of milk prices, as did the preceding Minnesota-Wisconsin (M-W) price series, as the basic means of price discovery for establishing milk prices to operate the Federal Order program. Discontinuing the BFP represented a major change because it replaced this previous system of direct, survey-based, price discovery with a system that indirectly discovered raw milk prices entirely by calculation from market prices of the products manufactured from that milk. The intricate product price formulas and their constituent coefficients that resulted took on the important function of accurately simulating the market realities of the complex transfer of price discovery from the markets for dairy products to the markets for unprocessed milk used to produce them.

At the same time, the Class I prices that were established by Congress updated the pre-existing Class I differentials by adopting an optional USDA-suggested price surface, which had been generated on the basis of 1990s milk market conditions and extended it coast-to-coast. All of the prices and price formulas of Federal Order Reform were premised upon the costs and realities of milk production and dairy product manufacturing which prevailed at that time.

Those market realities have subsequently changed as the U.S. dairy industry has undergone dynamic structural change since 2000, while the critical Federal Order dairy product price formulas and Class I differentials have, for the most part, remained static. For example, the location of U.S. milk production has shifted westward, manufacturing and transportation costs have increased significantly, and the southeastern states have become progressively more milk deficit. Also, the industry has seen the successful deployment of very large manufacturing plants, and yet many smaller-sized manufacturing plants remain critically important to satisfying the domestic and export demands for the U.S. milk supply. Additionally, the United States currently sells about 18 percent of its milk production as manufactured products in export markets, compared to about 5 percent in 2000.

These realities and others necessitate a pricing formula review that incorporates the Class I mover, Class I differentials, manufacturing cost (make) allowances, and other factors in the Class price formulas. The constituent parts of those formulas, including the products used, the make allowances, and the yield factors in the component formulas, the assumed composition of producer milk, as well as the Class I differentials, have become increasingly outdated, even those few previously updated, to the extent that the effective administration of the Federal Order program has become increasingly difficult.

NMPF has engaged in an almost two year-long comprehensive study of needed updates to the Federal Order pricing formula provisions. NMPF has undertaken this important activity with the essential and dedicated assistance of dozens of marketing experts from the staffs of its member cooperative marketing associations. In a series of over 200 mostly virtual meetings, this team

examined every detail of each of the current pricing formulas of the Federal Order uniform pricing regulations in 7 C.F.R § 1000.50-52. The goal was to develop a comprehensive, integrated, and balanced program of updates to these formulas, to realign them more fully with the structural realities of the current dairy industry and to address the disorderly marketing conditions which the growing misalignment has allowed to develop. This effort included consideration of mechanisms for making further updates in the future as the industry continues to evolve. The comprehensive package which resulted includes seeking additional legislative authority for USDA to conduct mandatory studies of manufacturing costs and product yield factors, seeking a change via ordinary rule-making to the regulations implementing the Dairy Product Mandatory Reporting Program (DPMRP), and five recommendations for amendments to the uniform pricing regulations for all Federal Orders.

The NMPF Board of Directors unanimously approved this package of recommendations, including the five recommendations for proposed amendments to all Federal Orders, which NMPF has submitted as the following proposals:

1. **Update the milk component factors for protein, other solids, and nonfat solids in the Class III and Class IV skim milk price formulas**

3. **Discontinue use of barrel cheese in the protein component price formula**

7. **Increase the make allowances in the component price formulas to the following:**

Butter	**$0.21 per pound**
Nonfat dry milk	**$0.21 per pound**
Cheese	**$0.24 per pound**
Dry Whey	**$0.23 per pound**

13. **Return to the "higher-of" Class I skim milk price mover**

19. **Update the Class I differentials throughout the United States**

Implementation of all five components of NMPF's comprehensive proposal will require amendment of certain provisions of the Federal Order uniform pricing regulations in 7 C.F.R § 1000.50-52, applicable to all Federal milk marketing orders, and 7 C.F.R. §1005.51(b), §1006.51(b), and §1007.51(b). This testimony is in support of Proposal 3, concerning Surveyed Commodity Products.

Proposal 3: Remove the U.S. average survey price for 500-pound barrel cheddar cheese from the computation of the protein component price

NMPF requests that the Secretary amend 7 C.F.R. § 1000.50(n), applicable to all federal milk marketing orders, as specified at the conclusion of this testimony, which would remove cheddar

cheese packaged in 500-pound barrels from the cheese reference prices specified in the Federal Order protein component price formula.

Disorder caused by the inclusion of 500-pound barrel cheddar cheese prices in the current computation of the protein price

The Class III milk price in Federal Orders is derived from calculations of component prices for protein, butterfat, and other solids. The protein component price formula references two survey price series for cheddar cheese submitted by manufacturers through the Dairy Product Mandatory Reporting Program (DPMRP) and reported in the weekly National Dairy Products Sales Report (NDPSR). These are the 40-pound block yellow cheddar cheese price and the 500-pound barrel cheddar cheese price. The total cheese price used in the protein price calculation is the weighted average of the block and the moisture-adjusted barrel price, plus $0.03 per pound, weighted by sales volumes reported in the survey. The respective reported sales volumes of block and barrel cheese are roughly equal on average, but with blocks ranging from 37 percent to 60 percent of total reported weekly volumes from 2017 through this past July.

The Federal Order Reform Final Decision explained the current cheese price computation:

> The NASS cheese survey price will be determined by adding three cents to the moisture-adjusted barrel price and then computing a [volume-]weighted average price using the block cheese price and the adjusted barrel price … Including both block and barrel cheese in the price computation increases the sample size by about 150 percent, giving a better representation of the cheese market. Since the make allowance [in the protein component price formula] is for block cheese, the barrel cheese price must be adjusted to account for the difference in cost for making block versus barrel cheese. The three cents that is added to the barrel cheese price is *generally considered to be the industry standard cost difference between processing barrel cheese and processing block cheese*.[1]

This method of computing the cheese price for the protein component formula worked reasonably well as long as the difference in the respective market prices of blocks and barrels remained close to the assumed $0.03 per pound processing cost difference. From 2000 to 2016, the spread between the NDPSR block and barrel cheese prices annually remained within a tight range of a few cents per pound. Subsequently, however, the correlation between the block and barrel prices deteriorated significantly starting around 2017. The weighted average spread of block over barrel prices in the weekly National Dairy Product Sales Report (NDPSR) during January 2017 through July 2023 was $0.120 per pound, with a much wider and more volatile range of -$0.305 per pound to $0.727 per pound. The highest monthly block-barrel price spread during this period was $0.69 per pound and the lowest was -$0.29 per pound (meaning that barrel

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[1] 64 Fed. Reg. 16,098 (emphasis added).

prices were higher than block prices). This change in price relationships is shown clearly in Figure 1.

Figure 1. Weekly NDPSR Cheese Price Spread, 2017-2023 td
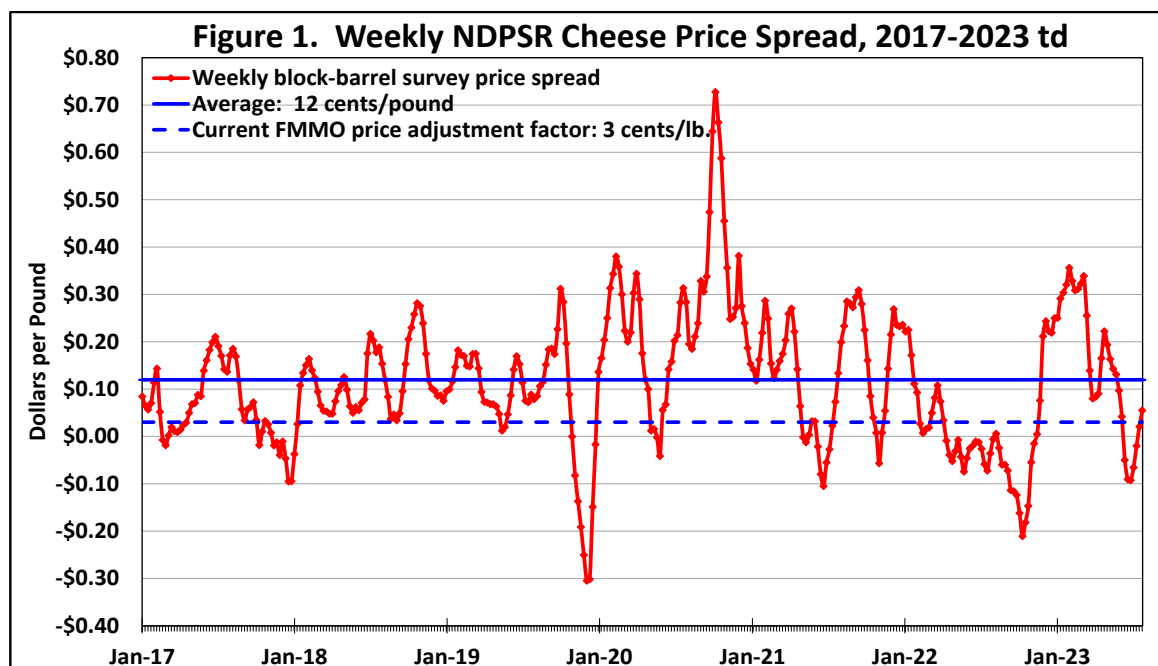
The CME block cheddar price is used as a pricing index for most cheese produced in the United States. Cheddar 40-pound blocks, 640-pound blocks, mozzarella, other American-type cheese, and other types of cheese, including cream cheese and Hispanic cheeses, typically use the 40-pound block price as an index for pricing purposes. Approximately 90% of natural cheese produced in the United States is sold using the CME 40-block price as a pricing index. The CME barrel cheese price is used as an index to price barrel cheese and processed cheese products but is not often used to price other natural cheeses. Working with its cheese-producing member cooperatives, NMPF estimates that the CME barrel cheese price is used to price only about 9% of total domestically produced natural cheeses during calendar year 2022, including barrels themselves.

The volatile block-barrel spread over the past five years has negatively impacted both dairy producers and processors. Historically, using both block and barrel prices in the Class III pricing formula effectively increased the volume of cheddar cheese reported in the NDPSR. As long as the block-barrel price spread was relatively stable and consistent at around $0.03 per pound, including both block and barrel prices did not result in unpredictable and disruptive fluctuations in the Class III price. Since 2017, however, the significantly wider and increasingly volatile block-barrel price spread has caused instability in the cheese market. It has reduced revenue for dairy producers because barrels, at approximately half of the price survey volume and an average price roughly four times lower than the current regulatory standard $0.03 per pound, over-represent the roughly 10% of total U.S. cheese production that relies on the CME barrel market as a price index, which accordingly results in a Class III price that undervalues milk used to produce cheese.

The Proposed Solution: remove the survey price for 500-pound barrel cheddar cheese from the computation of the protein price

From the Federal Order Reform Final Decision quote cited above, it is clear that the intent of using barrel cheese prices to determine the protein price was to bolster the volume of surveyed 40-pound block cheddar cheese for the purpose of determining the requisite cheese price to use in the protein component formula. It did so by adjusting the barrel cheese price to resemble a block cheese price. But what worked reasonably well for a decade and a half or so subsequently became a disorderly marketing condition when the market dynamics for barrel cheese deviated significantly from those for blocks, and the spread between the block and barrel prices widened and became unstable. Block and barrel cheddar cheese are no longer essentially the same product, simply in different packaging, as the current regulations effectively assume. This widening and increasing volatility of the two prices no longer results in barrel prices resembling block prices. The increase in the spread has lowered Class III prices, lowered producer prices, and created disorderly marketing conditions.

Eliminating the cheddar cheese barrel price series from the Class III price calculation will result in Federal Order pool values that more accurately reflect the value of milk used to produce cheese. It will reduce financial uncertainty for producers and processors by ensuring that the cheese price in the protein component formula represents the single basic commodity cheddar cheese product that prices almost all other cheese, rather than what have effectively become two different products. Price risk management opportunities for processors will be enhanced because there are risk management tools built around block cheese that do not exist for barrels. Existing risk management tools, including the Class III price and the cheese futures and options, will become more effective means to price cheese for customers and to manage input cost risk. cheese. Eliminating the cheddar cheese barrel price series from the Class III price calculation will create more orderly marketing in Federal Orders, for all of these reasons.

Calculated just arithmetically, eliminating the cheddar cheese barrel price series from the Class III price calculation would have increased the cheddar cheese price used in the Federal Order protein component calculation by $0.0431 per pound, which would have increased the Class III price by $0.41 per hundredweight, using average product prices for 2017-2022.

During 2019 through July 2023, the NDPSR weekly survey volumes represented 33 percent of total U.S. natural cheddar cheese production, 30 percent of U.S. dry whey production, and 9 percent of U.S. butter production. It is estimated that reported volumes of 40-pound block cheese represents about 16 percent of total U.S. natural cheddar cheese production. Eliminating barrel cheese from the protein component price formula would still provide adequate volume of cheddar cheese for price discovery purposes in determining a component price for protein, in the context of the corresponding percentages for butter and dry whey. Doing so would also bring the surveyed cheese price into conformity with those for butter, nonfat dry milk and dry whey in their respective Federal Order component price formulas, namely, in their use of a truly single

commodity product with a single price determined by a single spot market. That consistently effective practice for the other three products in their respective component price formulas, together with the unfortunate experience with deviating from that practice for cheese, lends powerful support for the adoption of Proposal 3.

This testimony provides an overview of our justification for adoption of Proposal 3. More detailed testimony will follow that supports all, or key portions of, Proposal 3, including testimony provided by Darin Hanson, representing NMPF member cooperative Foremost Farms USA, other members of the NMPF task force that developed our Federal Order modernization proposals, and producers who are members of NMPF member dairy cooperatives.

Economic and Market Impacts of NMPF's Proposed Changes

Dr. Scott Brown of the University of Missouri will testify later at this hearing on his analysis of the economic impact of adopting NMPF's five proposals previously described. His analysis will show that these proposals will have a modestly positive impact on the average price of milk received by dairy farmers, which will dissipate fairly rapidly. The resulting average prices are expected to converge within a few years to their "baseline" levels, i.e., levels expected to prevail in the absence of any order changes.

The changes proposed by NMPF will not affect the cost of producing milk nor constrain the supply of milk freely produced by the nation's dairy farmers in response to market price signals. Without either of these effects, the price of milk will continue to reflect the longer-term costs of producing it, which are not directly affected by the Federal Order regulatory changes proposed by NMPF. Any and all changes to the prices of individual dairy products, or to the Federal Order regulated cost of milk for processing individual dairy products generated by these proposals, will be limited to those necessary to reflect changes in the costs of manufacturing those products, changes in the costs of supplying milk to processors of those products, changes in the value of the milk supplied by producers to those processors, or other changes necessary to more closely align the regulated minimum value of milk with the market value of the products into which it is produced, as translated by the federal order product price formulas. Such realignment is critical to the effective functioning of the Federal Order program to ensure orderly marketing, given the fixed parametric nature of the product price formulas, coupled with the rapid evolution of the basic structural features of the U.S. dairy industry that those parameters are intended accurately to reflect.

Figure 2 below provides a perspective on the key issue of the impact on consumers of the Federal Order program, and potential changes to the regulatory provisions of that program. It charts the monthly Consumer Price Indices (CPIs) reported by the U.S. Bureau of Labor Statistics (BLS) over the past decade and a half for all items, which is the general measure of overall consumer price inflation, also referred to as the overall cost of living, together with the aggregate CPIs for all food and beverages, for all dairy products, and for all fluid milk products,

the principal regulatory focus of the Federal Order program. These CPIs reflect actual retail prices paid in all U.S. cities, but they are expressed in the form of indices, with their respective U.S. average retail prices during the 36-month period of 1982-84 each set to the value 100, to facilitate comparisons.

Figure 2. Consumer Price Indices (CPIs)

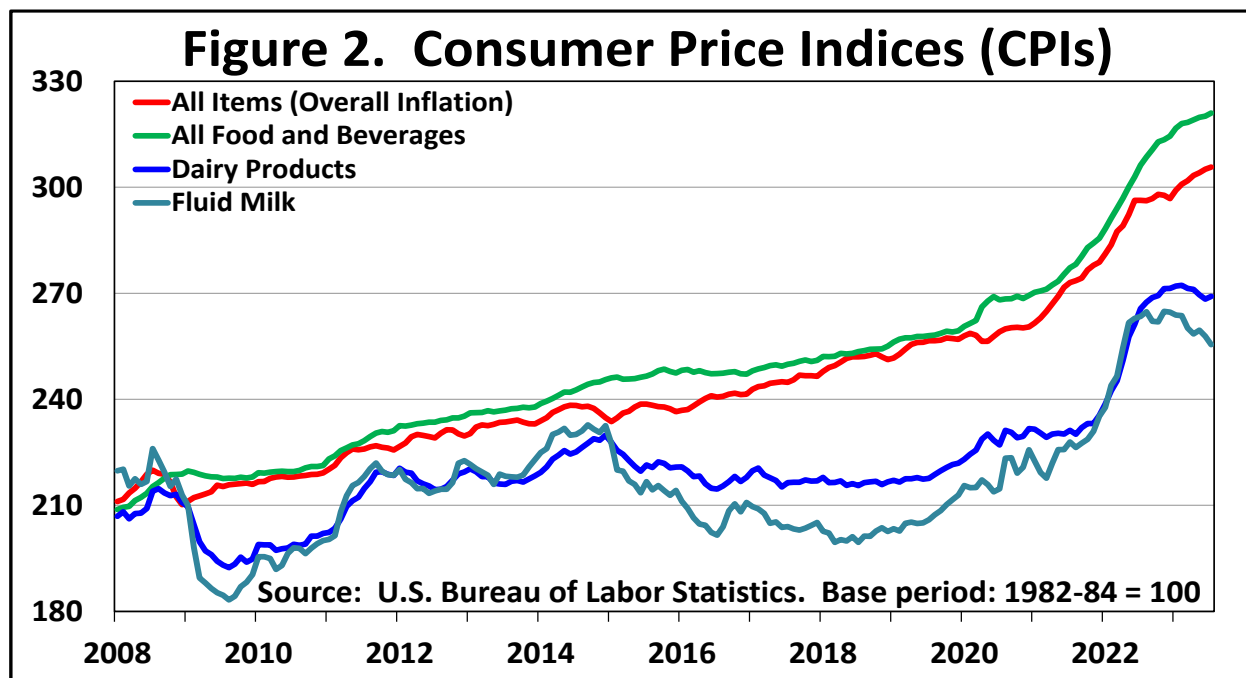Source: U.S. Bureau of Labor Statistics. Base period: 1982-84 = 100

Figure 2 shows that the retail prices represented by all four of these measures had increased as of 2008 by about the same amount, slightly more than doubling during the quarter-century since the index base period. From 2008, the overall cost of living and the cost of all food and beverages have both continued to increase at a relatively steady pace, which accelerated during the recent bout of inflation, with food and beverage prices slightly outpacing the overall inflation rate, particularly in recent months.

The less aggregated dairy and fluid milk CPIs have shown a greater sensitivity to the price of producer milk, including the 2009 price plunge, the price spikes of 2014 and 2022, and the stagnation of prices between these two peaks. This closer connection between farm and retail prices for dairy stems from the fact that the cost of raw milk has averaged about 31 percent of the retail value of dairy products since 2002, while the farm value of most food and beverage products represents a much smaller share of the total retail value the finished products, which accordingly reflect more closely the main drivers of overall retail price inflation, including such factors as energy, labor and transportation. However, these factors have also caused retail price inflation for dairy products to outpace general and food and beverage price inflation during the recent bout of general price inflation, but also to recover more quickly from it, with dairy product retail prices actually dropping this year while the two more general CPIs continued to increase.

But, of particular significance for the current purpose, the overall cost to consumers of dairy products, and fluid milk products in particular, has declined during the illustrated period relative

to both overall inflation as well as general food and beverage price inflation. One noteworthy datum is that the simple difference by which the monthly CPI for all fluid milk has fallen below the monthly CPI for all food and beverages reached its highest level ever in July 2023.

Agricultural production enjoys built-in productivity advantages due to its biological basis, which can generate increases in production per animal or increases in production per planted unit as a result of genetic improvements and other productivity enhancements unique to biological production processes. These advances generate unit cost reductions which the competitive nature farming passes on up the various agricultural and food marketing channels, eventually to consumers. This consumer cost reduction aspect of agriculture varies in direct relation to the proportion which the basic agricultural commodity represents of the total retail value of the resulting food products, which, as mentioned, is relatively high for dairy products. This aspect of agricultural production, coupled with the great productivity of U.S. agriculture, has resulted in the general cost of food representing one of the smallest proportions of total consumer income in the United States, compared to that in all other countries.

It is therefore very difficult to consider the facts presented in Figure 2, which reflect the relative influence of all economic factors at play in producing general, food and beverage, overall dairy product, and fluid milk product price inflation over the past decade and a half, a period that includes the continuous operation of the Federal Order program, and conclude that Federal Orders have had a deleterious effect on consumer welfare via the retail price of fluid milk and retail prices of dairy products in general. And, given the results of Dr. Brown's analysis, this will continue to be the case under the Federal Order modernization changes proposed by NMPF.

Another key issue is the impact of the Federal Order program, and potential changes to the regulatory provisions of that program, on small businesses. As stated in the notice for this hearing, most parties subject to a FMMO are considered a small business. A large majority of those are dairy farm businesses, which, for the purpose of the Regulatory Flexibility Act (5 U.S.C. 601-612) (RFA), are defined as a "small business" if they have an annual gross revenue of $3.75 million or less.

Table 1 provides simple estimates of the average herd size and average milk sales per herd of the producers pooled on the individual Federal Orders in 2022. These estimates are weighted averages by herd sizes in the individual states that lie wholly or partially in the respective Federal Order marketing areas. These estimates would indicate that most of the producers pooled in Federal Orders in 2022 would qualify as small businesses for the purpose of the RFA.

Table 1. Estimated Dairy Herd Statistics in Federal Milk Marketing Order Areas, 2022

Order #	Licensed Dairy Herds	Average Herd Size	Average Sales per Herd
		Head	*Mil.$/Yr*
1	3,668	171	$1.0
5	769	231	$1.3
6	56	1,617	$9.1
7	620	394	$2.0
30	8,338	352	$1.4
32	2,125	772	$3.2
33	4,107	211	$1.4
51	1,115	1,544	$8.7
124	508	777	$4.6
126	435	2,085	$12.5
131	80	2,463	$14.4

Estimates by National Milk Producers Federation

As mentioned previously, Dr. Brown's analysis and testimony will show that the Federal Order modernization changes proposed by NMPF will have a modest, positive impact on the average price of milk received by the mostly small businesses that are dairy farmers in the United States. Also as previously mentioned, any and all changes to the prices of individual dairy products, and to the Federal Order component and class prices resulting from these proposals, and therefore to the uniform prices received by dairy farmers in individual orders and regions, will be limited to those necessary to reflect changes in the costs of manufacturing those products, changes in the costs of supplying milk to processors of those products, changes in the value of the milk supplied by producers to those processors, or other changes necessary to more closely align the regulated minimum value of milk with the market value of the products from which it is produced, as translated by the Federal Order product price formulas. This will also apply to any processors and manufacturers of dairy products which are also small businesses.

Concluding comment and proposed regulatory changes

NMPF sincerely wishes to thank Secretary Vilsack and the Department for holding this important hearing and for thoughtfully considering adoption of its proposed amendments to the Federal milk marketing order regulations. NMPF has devoted considerable time and resources to thoughtfully considering and recommending the important changes it considers necessary to correct the growing misalignment between the dynamic changes in the U.S. dairy industry since Federal Order Reform and the largely unchanged factors in the critical federal order component and class price formulas originally adopted at that time. Together, NMPF is requesting the Secretary to amend certain provisions of 7 C.F.R. § 1000.50-52, applicable to all Federal milk

marketing orders, and 7 C.F.R. §1005.51(b), §1006.51(b), and §1007.51(b). The changes to these regulations that Proposal 3 would entail are as follows (includes some changes pursuant to Proposal 7):

§ 1000.50 Class prices, component prices, and advanced pricing factors.

* * * * *

(n) ***Protein price.*** The protein price per pound, rounded to the nearest one-hundredth cent, shall be computed as follows: *Strike all subsequent parts of this paragraph and insert in lieu thereof*:

> **(1) Subtract 24.00 cents from the U.S. average AMS survey price for 40-lb. block cheese reported by the Department for the month and multiply the result by 1.383;**
>
> **(2) Add to the amount computed pursuant to paragraph (n)(1) of this section an amount computed as follows:**
>
>> **(i)   Subtract 24.00 cents from the U.S. average AMS survey price for 40-lb. block cheese reported by the Department for the month and multiply the result by 1.572; and**
>>
>> **(ii)   Subtract 0.9 times the butterfat price computed pursuant to paragraph (l) of this section from the amount computed pursuant to paragraph (n)(2)(i) of this section; and**
>>
>> **(iii)   Multiply the amount computed pursuant to paragraph (n)(2)(ii) of this section by 1.17.**