

BEFORE THE SECRETARY OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

<i>In the matter of:</i>	)	
	)	
Proposed Amendments of Tentative	)	Docket No.
Marketing Agreements and Orders	)	A0-14-A74, <i>et al.</i>
	)	
(Class III/IV Price Make Allowances)	)	DA-06-01
	)	

Post-Hearing Brief of the National Milk Producers Federation

The National Milk Producers Federation (NMPF) hereby submits its post-hearing brief in the above-captioned proceeding. NMPF is an association that represents the interests of more than 50,000 of America’s estimated 65,000 dairy farmers.

The proceeding was initiated to consider a proposal to update the manufacturing cost allowances for butter, nonfat dry milk, cheddar cheese, and dry whey. These “make” allowances are used in calculating the minimum prices for Federal order pooled milk used to make these products and others. Proponents seek these changes because in recent years manufacturers have experienced significant increases in their costs of making these benchmark products. Because of the way that make allowances work in the Federal order system, those manufacturers are constrained from passing on increased costs to the market because any market price increase automatically results in an equivalent increase in the price they have to pay for their milk.

The most volatile element of cost, by far, has been energy. Increases in other costs have been more gradual, and have been partially offset by increased productivity in

the manufacturing process. (Exhibit 58/60) Energy price increases in recent years have overshadowed other cost changes and gains in productivity. These increases have not been covered by the current fixed make allowance. The drastic rise and fall of these costs makes a one-time fixed increase in the make allowance inappropriate. When energy prices rise dramatically, fixed make allowances fail to provide adequately for plant costs; when they fall precipitously, they provide an unfair windfall to processors at the expense of producers. For example, if a fixed increase were implemented on the basis of the extraordinarily high natural gas costs incurred in late 2005, the resulting make allowance would now be excessive, as natural gas prices have regressed toward their long-term norms, as our January testimony anticipated.

NMPF therefore urges USDA to adopt a mechanism that would adjust the make allowances on a monthly basis for changes in energy costs, using the most recent available Producer Prices Indices for Industrial Electricity and Industrial Natural Gas. A regular adjustment to this highly volatile element of the cost of dairy processing is the best way to maintain equity between producers and the processors of the benchmark products.

NMPF recommends that the energy index adjustments be calculated from the Producer Price Indices for Industrial Natural Gas (BLS Series WPU0553, Base = Dec 1990) and Industrial Electric Power Distribution (BLS Series WPU0543, Base = 1982), weighted by the direct costs of electricity and fuels per pound of product, as estimated for 2004 by USDA/RBS and CDFA and for July 2004 through June 2005 by Dr. Stephenson.

At the recent hearing, notice was taken of the Producer Price Indices for Industrial Electricity and Industrial Natural Gas, available through the date of the hearing. Dr.

Stephenson used another Producer Price Index for Natural Gas, but testified that “if I had made the choice with a clear head, I would have used the industrial natural gas index here. But I thought that’s what I had grabbed. But when I looked back at that, I didn’t.” (Transcript, September 14, p. 105-106) NMPF supports Dr. Stephenson’s ultimate conclusion that the industrial natural gas PPI (WPU0553) is the appropriate basis for adjusting dairy processing fuels costs.

Otherwise, NMPF maintains that the data that Dr. Stephenson presented at the September 14th and 15th hearing is consistent with NMPF’s energy indexing proposal. Upon his cross-examination, Dr. Stephenson specified fuel and electricity costs for each of the three dairy products, as follows (Transcript, September 14, p. 134):

	Fuel Costs	Electricity Costs
Cheddar Cheese	1.09¢	0.82¢
Butter	0.99¢	0.38¢
Nonfat Dry Milk	2.37¢	1.02¢
Whey	2.27¢	2.00¢

He specified that some 63% of the observations were for the 12-month period from July 2004 through July 2005. (Transcript, September 14, p. 29) If Dr. Stephenson’s data is incorporated into the new manufacturing cost allowances, this could serve as the base period for energy indexing this data to provide monthly energy price adjustors.

NMPF’s statements presented at hearing have specified in detail how an energy cost adjustment could be constructed, evidence of the applicability of monthly energy cost adjustors, and specific language to effect such adjustors. We refer to those statements. (Exhibits 58/60 and 77)

Conclusion

Regardless of the data upon which USDA bases the revision of the make allowances used to calculate the Class III and IV prices, NMPF recommends that those make allowances incorporate energy indexing, per our testimony at both hearings. Each set of data has a basis for establishing a base period for the application of changes in the relevant Produce Price Indices.

Since energy costs are, by far, the most variable element of dairy manufacturing costs (other than raw milk prices), energy price indexing is the only means of maintaining meaningful make allowances, even within the time between the hearing notice and the final decision.

We urge Dairy Programs and the Secretary of Agriculture to consider an energy cost adjuster that incorporates monthly energy cost indexing.

Respectfully submitted,



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