



Maine
Dairy
Industry
Association

September 27, 2006

Gino Tosi, Associate Deputy Administrator
USDA / AMS / Dairy Programs
Order Formulation and Enforcement Branch
Stop 0231 – Room 2971
1400 Independence Avenue, S.W.
Washington, DC 20250-0231

Re: Consideration of additional proposals to the Federal order Class III & IV price formulas

Dear Associate Deputy Administrator Tosi,

The Maine Dairy Industry Association (MDIA), which serves all Maine dairy farmers producing milk for the commercial market, has been following the request for changes in the manufacturing allowance of the Federal order Class III and IV product price formulas. MDIA submitted written comments to the original proposal by Agri-Mark Cooperative that had its administrative hearing January 23-27, 2006 (see attached).

Now that the process has moved into a second stage of review that includes a request for additional proposals, MDIA is presenting the following information for consideration.

PROPOSAL

MDIA's proposal is that the Federal order de-couple the Class I price from Classes III and IV when setting the monthly Class I minimum price. Instead of building upon the National Agricultural Statistics Service (NASS) plant price survey, which over time has near perfect correlation to the speculative trading of the Chicago Mercantile Exchange (CME) and directly influences Class III and Class IV pricing, Class I pricing should be based on the actual costs of producing milk. The USDA's Economic Research Service (ERS) conducts regional and even some individual state studies (Monthly Milk Cost of Production Estimates) that identify the costs associated with producing milk. In addition, just as the manufacturing sector of the dairy industry is entitled to a reasonable return to recover costs through Federal order pricing, so should the producer sector be able to recover their costs by basing the minimum Class I price on the real costs of producing the raw material (milk) for dairy products.

JUSTIFICATION FOR PROPOSAL

In the original Agri-Mark proposal, the objective was to update the make allowance formulas to reflect current market costs and dynamics. MDIA supports the need for the processing sector to recover their costs through the Federal order pricing system and respects their right to petition for changes to accomplish that goal. However, any effort to secure a more accurate representation for pricing within the Federal order system should not involve mechanisms that simply shift the cost burden from the processing sector to the producers.

The original proposal, because it would change the producer price for Class III and IV, also resulted in a lowering of the prices for Class I and II. In the end, the processor would obtain a more complete recovery of their costs from the pocket of the producers. In no other industry would the manufacturer be able to charge the supplier of the raw materials for increased costs of manufacturing. In all other situations those costs would be passed along to the next level of processing or the retail sector. And it would be unheard of to simultaneously offer the producers a lower price for their original product. However, this is exactly what would result from acceptance of the original Class III & IV make allowance proposal as previously presented.

A part of the solution to that problem is to remove the connection between Class III and Class IV prices and the minimum Federal Order price for Class I milk. Class I fluid milk does not operate like the products in the other classes (with a few Class 2 exceptions). Class I is a highly perishable product that cannot be stored or stockpiled and is not an item that can be traded on the CME. It is delivered more directly to meet regional consumer demand and is more susceptible to geographic production shifts. The Federal order system should utilize a better price discovery system to ensure a reasonable rate of return to producers while providing a basis for a steady supply of fluid milk to US consumers.

The demographic changes in the U.S. dairy industry over the last ten years show a dramatic shift from some regions to others. The increases have been to accommodate new processing facilities for Classes II, III and IV. Very rarely have we seen recent production expansions in the dairy industry to accommodate Class I processing (not including conversions from conventional to organic milk bottling).

In almost every other manufacturing industry, the raw product cost drives the cost of the manufactured goods. The supply and demand system works to keep profit margins down, but suppliers of raw materials that are in demand are able to receive prices that allow them to continue supplying product. In the dairy industry, we allow the speculated value of the processed end product to dictate the price paid for the raw product.

The Agricultural Marketing Agreement Act of 1937 and its subsequent amendments (herein referred to as The Act) were enacted to prevent disruptions and imbalances in the orderly exchange of commodities and to insure that such transactions were conducted in a manner benefiting the national public interest. The Act conferred the power to the Secretary of Agriculture:

“to establish and maintain such orderly marketing conditions for any agricultural commodity... as will provide, in the interests of producers and consumer, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.” (Subsection 4 added by section 401 of the Agricultural Act of 1954, 68 Sts. 906).

In the aftermath of September 11, 2001 the country has realized the importance of having access to local supplies of basic food necessities. In order to ensure that regional supplies of fresh fluid milk would be available, the Federal order system must ensure that local producers will continue to operate throughout the country. The historically low prices in the last five years have dramatically eroded the dairy industry in many areas of the country. The impact of such a loss is a reduced ability to access a stable and sustainable supply of milk. It has also resulted in the loss of small businesses that created important economic activity for rural areas, from not only the farms, but also from the agri-businesses that depended upon a critical mass of dairy farms to remain viable. Along with the economic losses, productive agricultural land is the most efficient way to preserve open spaces and promote environmental stewardship – both of which are prevailing public policy objectives.

Under the current Federal order pricing system, the differences in the basic costs of producing milk from region to region are not recognized; they are assumed to be uniform. There needs to be a mechanism geared to each specific region of the country that establishes a baseline cost of production that is used to determine minimum pricing, thus ensuring that a producer can recover a significant portion of the actual cost of producing milk. Unless this change takes place, it is likely that certain regions of the country will continue losing dairy production to a point where a fresh supply of milk would be unavailable to certain areas of the country in a time of national emergency.

A look at national retail milk pricing trends show that the prices charged to consumers for Class I milk have been relatively stable, despite dramatic downturns in the prices paid to producers. It has become more evident that while the NASS plant price survey/CME may be reflective of the future supply and demand of stored dairy products, it is not an accurate reflection of the supply and demand for Class I.

More importantly, there is no other mechanism within the Federal order pricing system to provide a recovery of costs for the producer segment of the industry. This is fundamentally unbalanced because throughout the system there are tools for the processing and retailing segments of the industry to recover their costs and to secure a return on investment – the original make allowance proposal that was heard in January 2006 is just such a mechanism for the processing sector.

Subsection 18 of The Act speaks specifically to the pricing of milk. It directs the Secretary of Agriculture to take into consideration before setting any minimum prices to “ascertain

the parity prices of such commodities". While this phrase may have many interpretations, the section goes on to say,

"The prices which it is declared to be the policy of Congress to establish in this section 2 of this title shall for the purposes of such agreement, order, or amendment, be adjusted to reflect the price of feed, the availability of feeds, and other economic conditions which affect market supply and demand for milk or its products in the marketing area to which the contemplated marketing agreement, order or amendment relates."

This clearly points to a direct consideration of the costs of production when setting the monthly minimum producer prices. The Act then proceeds to state that whenever the findings are that Federal order prices are not reflective of the cost of production or other economic conditions,

"(The Secretary) shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs and be in the public interest."

Again, the direction is clear - that regional dynamics must be considered to ensure and reflect the public policy objectives and needs of the entire dairy industry, from the producer and including the processor all the way to the consumer. In order to be in compliance with the intent as well as the explicit directions of The Act, changes are required in the way the Federal order sets producer prices.

Accessing factual data on the producer cost of production by region is fairly simple because ERS currently compiles that data on a regular basis. Utilizing this data to set minimum prices would only require an understanding that such cost of production studies would continue to be done on a regularly occurring basis with the ability to periodically update the figures to reflect changes in the cost of key inputs within each region. As long as the data collected and the frequency of the updates were uniform throughout the country, the result would be a more accurate representation of the trends in production and more stability in pricing that would lead to more stability in the regional availability of Class I fluid milk. Because the ERS surveys are regional, they provide a built in mirror to reflect actual conditions occurring within different sectors of the country, rather than a one-size-fits-all approach that does not work for most farmers.

Since the pooling process would not be affected, this concept should not negatively impact producers who are shipping milk to supply Class II, III and IV manufacturing plants. If there is concern about the impact of changing the make allowance on Class II, III and IV producer prices, the Federal order could consider basing the minimum prices in those classes on regional retail prices for the finished dairy products. As previously mentioned, the retail prices for items in those classes have remained relatively stable over the last few years at the same time that futures prices on the CME were on a roller coaster.

As stated earlier, MDIA does not oppose efforts by the processing sector of the dairy industry to make changes to the make allowance in order to recover their costs of manufacturing. Producers deserve the same consideration and should have a system that ensures a mechanism for the recovery of the costs of production and a reasonable return on investment allowance. What is fair and equitable for one sector of the dairy industry should be applied equally in theory to include all sectors of the industry.

In raising these issues, it is the intent to stimulate a more complete conversation about the needs of all parts of our industry to allow for enhanced stability in pricing, regional food security and opportunity for the growth and success of our entire industry, from producer to processor to US retail consumer to the export of US dairy products around the world.

MDIA and its members appreciate your consideration of this proposal.

Sincerely,



Dale Cole
President
Maine Dairy Industry Association

cc: Mr. Erik Rasmussen, Market Administrator, Northeast Milk Marketing Area
Hon. Charles E. Summers, Jr., Regional Administrator Region I, U.S. Small
Business Administration
Hon. Olympia J. Snowe, U.S. Senator, Maine
Hon. Susan M. Collins, U.S. Senator, Maine
Hon. Thomas Allen, U.S. Representative, District 1 - Maine
Hon. Michael Michaud, U.S. Representative, District 2 - Maine
Mr. Robert Wellington, V.P. for Economics, Communications & Legislative
Affairs, Agri-Mark Dairy Cooperative
Mr. Seth Bradstreet, Commissioner of Agriculture, Maine
Mr. Stan Millay, Executive Director, Maine Milk Commission