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RE: Request for Proposals on Class III and IV Pricing Formulas
Docket No. AO-A74 et al; DA-06-01
Public Information Session
Docket No. DA-07-02

Maine Dairy Industry Association (MDIA), a trade organization representing all dairy farmers operating in the state of Maine, hereby submits a proposal for change to the Class III and IV pricing series. The proposal is submitted under Docket Nos. AO-A74 et al and DA-06-01 and also arises from MDIA's participation in the Public Information Session, Docket No. DA-07-02, at which the Department allowed for submission of proposal modifications not later than December 20, 2006.

MDIA requests that its proposal be considered at the forthcoming hearing on Class III and IV Product Pricing Formulas.

Proposal: Incorporate into 7 CFR § 1000.50(h) and (j) a factor to account for some or all of the monthly spread, if any, between the component price calculation and a competitive price calculation for equivalent Grade A milk.

Explanation

MDIA's proposes to partially restore competitive pay price valuation to the Class III and IV pricing series. Competitive pay price valuation provided the basis for pricing all milk in the Federal Order System for the historic period prior to the recent adoption of component pricing. The department's 1961 adoption of the M-W Price was based on the

economic premise that, “in a highly competitive economy, dairy concerns will tend to purchase milk at prices commensurate with the more efficient concern’s ability to pay for the product.”¹ The probity of this underlying principle for milk pricing was again relied upon when the Department refused to replace competitive pricing with component pricing in its 1994 decision establishing the BFP.

The appeal of this historic pricing concept “from the standpoint of sound economics” was again recognized by the BFP Replacement Committee during the FAIR Act Market Order reform rulemaking process² during its consideration of the four alternative pricing options. The Committee rejected the attempt to establish a national competitive price valuation for Grade A milk, however, as “questionable in [its] ability to reflect the manufactured milk market”³, and turned instead to component pricing.

From a processor standpoint, the transformation of the pricing series to component pricing may well have corrected the alignment and competitive balance of the national manufacturing market as intended, and yielded corresponding expansion and profitability of the manufacturing dairy sector. From the producer standpoint, however, this radical change away from competitive price valuation has not yielded any real improvement. Producers remain excluded from sharing commensurately in any enhanced downstream value of their raw product, and instead continue to operate in an environment of marginal return, at best.

Component pricing based on NASS/CME - based commodity pricing has had the additional negative impact of increased producer price volatility. This volatility results from the new series’ sole reliance on what is essentially a speculative calculation of value, reflecting at best a “thin” market in any event.

These continued imperfections in the valuation and volatility of the raw product price substantially reflect the current pricing series’ disconnection from the “sound” economic principle of pricing based on competitive valuation against the overall, actual marketplace. MDIA proposes, accordingly, a partial re-assimilation of competitive pay

¹ R. Cropp and E. Jesse, “USDA’s Recommended Decision on Replacing the M-W Price”, University of Wisconsin Madison, Department of Agricultural Economics, Marketing and Policy Briefing Paper Series, Paper No. 48 at page 8, 1994.

² Study Committee Report (www.ams.usda.gov/fmor/bfp.pdf) at page 5.

³ Id at page 6.

price valuation back into the component pricing series. In addition to providing for a better grounding of the value calculation, assimilation of a measure of the intrinsic raw product value back into the formula should also serve to dampen the volatility of the pricing calculation.

Accepting for purposes of this proposal that component pricing has corrected prior downstream market misalignments caused by an outdated M-W pricing series, the proposal would retain existing component price calculations for Class III and IV. Under the proposal, an additional calculation and adjustment would be made to factor in some or all of the monthly spread, if any, between the component price calculation and a competitive price calculation for equivalent Grade A milk.

The factor would be derived by running an updated version of the Department's 1996-97 simulated analysis of a competitive pay price for Grade A milk. That simulation, for the period 1994-96, was developed based on a national survey of plants located in nine states, including California. As described in the proposed rule, this price series further attempted to mirror a competitive procurement environment for Grade A milk by incorporating "an adjuster to attempt to remove the effect of the current regulation and to reduce it to a level more comparable to the current BFP."⁴

MDIA proposes further modification of the survey instrument as necessary to adapt it to changes in the regulatory environment, particularly the intervening change to component pricing. If component pricing has indeed served to rationalize the downstream market's regulatory imperfections resulting from the old M-W/BFP series, the survey instrument should now prove capable of identifying the spread, if any, between the component and competitive price valuation of Grade A raw milk, and to allow for calculation of the appropriate adjustment factor.

The factor would need to be further calibrated to further account for the competitive alignment between the California and federal systems. As the survey instrument includes California plants, any competitive misalignment that might result would be disclosed, and could be provided for.

⁴ Federal Register/Vol.64, No. 63, April 2, 1999, Page 16294.

In closing, it should be noted that the design of MDIA's proposal – base component pricing adjusted for competitive pricing - mirrors the design of the BFP in the obverse - or base competitive pricing adjusted by component pricing.

MDIA believes that its proposal would again provide for proper incorporation of the “sound” economic principle of competitive pricing into the FMMO pricing series.

Respectfully submitted,

Daniel Smith

Daniel Smith, Esq.
On behalf of Maine Dairy Industry Association

cc: Dale Cole, President
Maine Dairy Industry Development