

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

In re:

Milk in the Northeast and Other Marketing Areas

7 CFR Parts 1000 *et seq.* Docket No. 23-J-0067;

AMS-DA-23-0031

CARMEL, INDIANA

SEPTEMBER 2023

**TESTIMONY OF WILLIAM SCHIEK
ON BEHALF OF DAIRY INSTITUTE OF CALIFORNIA
REGARDING NATIONAL HEARING
ON FEDERAL MILK MARKETING ORDER PROPOSALS**

My name is William Schiek. Since January 2020 I have been Executive Director of the Dairy Institute of California (Dairy Institute). From 1997-2019, I was Economist for Dairy Institute. As Executive Director, I am responsible for overseeing the entirety of Dairy Institute legislative and regulatory agenda, assisting member companies with regulatory questions, and keeping members informed regarding market trends and legislative and regulatory developments. As Economist, I was, and remain, responsible for assisting member companies with development of dairy policy positions, conducting analysis of dairy and agricultural market trends, member education with respect to dairy pricing and risk management, serving on industry committees and advising on dairy policy issues, testifying at Federal Order hearings, providing analysis to support the Institute's legislative efforts, and general industry and government relations.

Prior to joining Dairy Institute's staff, I was Assistant Professor of Agricultural Economics at Purdue University in West Lafayette, Indiana from 1991 to 1997. At Purdue, I had responsibility for teaching courses in Agricultural Marketing and Food Business Management. I conducted research on a variety of food and agricultural marketing topics, including dairy marketing topics. From 1982 to 1989, I was employed by the New York-New-Jersey Milk Market Administrator's Office (Federal Order Number 2) as Cooperative Relations Specialist

Dairy Institute of California

Dairy Institute is a trade association representing fluid milk processors and dairy product manufacturers with plants in California. Dairy Institute's offices are located at 1127 11th Street, Suite 718, Sacramento, California, 95814. The Dairy Institute provides member companies with market and regulatory information services and advises them on regulatory and legislative issues impacting their business operations. The Institute also serves as its members' primary advocate on dairy legislative and regulatory matters. Our membership includes companies who process fluid milk and cultured dairy products, frozen dairy products and ice cream mix, cheese, and some packaged Class IV products, including butter and condensed and evaporated milk. The positions

on the proposals under consideration at this hearing were adopted by Dairy Institute's Board of Directors.

Dairy Institute Regulated Pricing Principles

Dairy Institute believes that regulated prices should be minimum prices that undergird the market. Disorderly marketing results from setting prices too high, whereas the market corrects if prices are set too low. Regulated prices should allow for the use of competitive premiums to direct milk and to highest and best use, and therefore, minimum prices should not intrude on the market so as to distort natural market signals. Dairy policy should encourage, or at least not discourage, investment, innovation, and new product development as these are keys to unlocking more demand for dairy products. The minimum regulated manufacturing class prices (Class III and IV) should not be set above market clearing levels. In its 1999 Final Decision on Federal Order reform, USDA stated (64 Fed. Reg. 16026, 16094-16095 (April 2, 1999)):

“The importance of using minimum prices that are market-clearing for milk used to make cheese and butter/nonfat dry milk cannot be overstated. The prices for milk used in these products must reflect supply and demand, and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit.”

In setting regulated milk prices, the danger is not in setting a minimum price that is too low, but in setting it too high. Regulated prices that are set too low (below the marketing clearing level) can be compensated in the marketplace through competitive premiums. Regulated prices that are set too high can lead to the milk produced by dairy farmers being dumped at the farm or moved out of area to find a processing home. Minimum regulated prices must be set to levels where the plants can clear the market and operate profitably. Dairy Institute also believes that performance-based pooling standards are necessary to direct milk to Class I uses and that Class I differentials should not be considered pure price enhancement for producers but exist (along with performance standards) to encourage suppliers to serve the Class I markets.

Dairy Institute's Positions on Submitted Proposals

Milk Composition

Proposal 1. The National Milk Producers Federation (NMPF) proposes to increase the assumed protein and other solids in Class III skim formula, and nonfat solids in Class IV skim formula to national component averages. Specifically, NMPF proposes increasing the assumed nonfat solids test in Class IV skim to 9.3% and the protein test to 3.3% and the other solids test to 6.0% in Class III skim. This change would increase the cost of Class I skim in all orders, and the prices of Class II, III, and IV skim in the four fat-skim pricing orders. **Proposal 2.** National All Jersey (NAJ) proposes annually updating assumed milk components in the Class III and Class IV skim milk formulas using the previous year's weighted average of component tests from MCP orders, with a 12-month implementation lag.

Dairy Institute opposes both Proposal 1 and Proposal 2. Regarding manufacturing classes in fat-skim orders, it is true that milk with higher components will lead to higher finished product yields. A good argument can thus be made that producers should receive a revenue benefit from the higher component levels they produce, which result in higher yields in Class II, III, and IV products. However, if underpayment is the issue, a better solution is for producers in those skim milk/butterfat pricing orders to petition USDA for a change to multiple component pricing. Such a change would ensure that handlers who derive a yield benefit from higher components would compensate their suppliers for that benefit. Components vary by order. Utilizing the average component tests from the multiple component price (MCP) orders could result in manufacturers overpaying relative to the components they actually receive, particularly if fat-skim orders' average components are lower than those in MCP orders. Component data is available from USDA for the orders that currently have component pricing. The current fat/skim orders could have lower component tests than others, particularly in summer months.

Regarding Class I, the changes in Proposals 1 and 2 would impose higher milk costs to fluid milk processors. Additional solids in Class I do not confer the same yield benefit as they do with manufactured dairy products, so there does not appear to be a valid economic justification for

applying the proposed change to Class I. Furthermore, this proposal does not seem consistent with the idea of regulated prices as minimum prices, and there does not appear to be much evidence that fluid milk processors generally receive milk at MCP-order average component tests. The Dairy Institute believes that Proposals 1 and 2 should not be adopted.

Surveyed Commodity Products

Proposal 3. NMPF proposes eliminating barrel cheddar from the cheese price calculation in the Class III formula. **Dairy Institute opposes Proposal 3.** The relationship between block and barrel prices has become more variable since 2000 when FMMO reform was implemented. Block and barrel markets are related, though not identical. Eliminating barrel prices from the Class III price calculation will put barrel cheddar manufacturers' margins under increased pressure when block prices exceed barrel prices as Class III milk prices, based solely on blocks, would be higher than they are now. Eliminating barrels also lowers the cheese volume that is used in establishing milk prices. NDPSR block survey prices are still largely driven by CME block pricing. If we were to eliminate barrels from NDPSR, there would be a somewhat greater likelihood of Class III prices being subject to thin market problems. Barrels are an important outlet for producers' milk and their pricing conveys information about the overall supply and demand balance for cheddar. Such information would be lost from FMMO prices if barrels were eliminated from the formula.

Proposal 4. The American Farm Bureau Federation (AFBF) proposes adding 640-pound cheddar blocks to the cheese price calculation in the Class III formula. **Dairy Institute opposes Proposal 4.** While the inclusion of blocks would add more volume to the NDPSR survey price, it would add relatively little in the way of new pricing information to the extent that 640-pound blocks are priced based on the 40-pound block price.

Proposal 5. AFBF proposes adding unsalted butter to the butter price calculation in the butterfat price formula. **Dairy Institute opposes Proposal 5.** It is our understanding that most of the exported butter is unsalted and is also manufactured to international customers' requirements of 82% milkfat. Domestic butter is 80% milkfat, and therefore a less expensive product. There is

also a question of how subsidies on exported butter would be handled in the price reporting of the product.

Proposal 6. California Dairy Campaign proposes adding mozzarella to the cheese price calculation in the Class III formula. **Dairy Institute opposes Proposal 6.** There are multiple types of mozzarella products sold and no clearly definable or agreed upon commodity-type product. Mozzarella manufacturing requires additional steps and is therefore likely to have different costs than cheddar and different product yields. Including mozzarella prices in the cheese price survey, without accounting for these manufacturing differences, would lead to an inaccurate representation of the milk value of the product. Trying to account for all the differences between cheddar and mozzarella would unnecessarily complicate the formula. Dairy Institute believes that the minimum regulated price should be based on a definable commodity product with established standards. Cheddar cheese is the best product to be representative of the value of milk used in making cheese.

Class III and Class IV Formula Factors

Proposal 7. NMPF proposes increasing manufacturing allowances to consensus levels of the following values: Cheddar Cheese \$0.24/lb., Dry Whey \$0.23/lb., Butter \$0.21/lb., Nonfat dry milk (NFDM), \$0.21/lb. **Dairy Institute opposes Proposal 7.** There is no transparency as to how the consensus make allowance levels in the proposal were determined. It is extremely difficult to evaluate how these consensus levels relate to actual plant costs of NMPF members or how representative they are of current dairy manufacturing generally. NMPF witnesses have consistently acknowledged that manufacturing costs are higher than the levels in Proposal 7, significantly higher than the current make allowances established in 2008, but NMPF has provided little information regarding how far below current costs its proposed levels are. Also, the proposal lacks any timeline as to how and when make allowances will be updated to reflect current costs.

Proposals 8 and 9. Wisconsin Cheesemakers Association (WCMA) and IDFA have identical proposals to increase the make allowances for cheese, dry whey, butter, and NFDM,

based on the simple average of 2022 costs derived plant surveys (Stephenson study) and 2022 cost estimated via regression analysis of CDFAs manufacturing costs data (Schiek study). **The Dairy Institute supports Proposals 8 and 9.** Under the WCMA/IDFA proposals, 50 percent of the change from current costs would be implemented in year one, with the remaining 50% being added in equal increments over the following 3 years (4-year total implementation) until the full 2022 costs are attained, OR until dairy manufacturing costs from a new USDA audited survey are available. Manufacturing costs were last updated in 2008 based on 2006 and 2007 data. An average of Stephenson survey data with CDFAs data was employed by USDA to establish the current make allowances in 2008. For the regulated prices generated by the end-product pricing formulas are to accurately reflect the value of milk to manufacturing plants, it is important that the manufacturing costs be as accurate and current as possible. Given the time that has elapsed since make allowances were last updated, it is important that they be amended. IDFA and WCMA's approach of using average cost data from two different data approaches is reasonable given USDA's history of employing manufacturing cost data compiled by Dr. Stephenson and CDFAs. The averaged cost data is more moderate than either study alone. Schiek's cheese cost estimates were higher than Stephenson's, while Stephenson's butter, NFDM, and whey cost estimates were higher than Schiek's.

Proposal 10. Select Milk Producers (Select) proposes increasing the cheesemaking fat recovery factor in the Class III Formula to 93% from its current 90% value. **Dairy Institute opposes Proposal 10.** Select's proposal would increase the butterfat yield in cheese from 1.572 to 1.624. In the past, a fat recovery value in the formula at 90% made sense because, even though some of the more efficient plants achieved higher fat recovery, older plants may not have been able to achieve the higher fat recovery of the most efficient, newer plants. Therefore, from our view, a fat recovery of 90% in the formula was consistent with the notion of regulated prices as minimum prices. Select has brought us expert testimony suggesting that fat recovery in newer cheese plants, or those using newer vat designs, may well be more than 90%, although a specific

level is not known. Our opposition stems from the fact that we do not have data regarding fat recovery levels across many plants representative of the cheddar manufacturing industry.

Proposal 11. Select proposes to update the assumed farm-to-plant shrink factor in the Class III protein price formula to account for actual farm-to-plant shrink based on Select data. This would increase the yield factors for butterfat (1.211 to 1.22), protein (1.383 to 1.386), and butterfat in cheese (1.52 to 1.582). **Dairy Institute opposes Proposal 11.** As was the case with Proposal 10, our opposition to Proposal 11 is based on the lack of broader data available on farm-to-plant shrinkage. The witness from California Dairy Inc. (CDI) presented testimony suggesting there are reasons to expect that farm-to-plant shrink in California might be higher than Select's proposal due to less than tanker-load shipments. Given the smaller farm sizes in the Northeast and Midwest, farm to plant shrink there is likely even higher.

Proposal 12. Select proposes to increase the NFDM yield factor in the Class IV formula from 0.99 to 1.03. **Dairy Institute opposes Proposal 12.** Nonfat dry milk yields based on the solids going into the NFDM dryer are likely higher than the current formula yield of 0.99 owing to the presence of some amount of moisture in the finished product. However, not all the nonfat solids in producer milk end up in the NFDM dryers. Some nonfat solids from cream remain in the liquid by-product of butter churning (buttermilk), and those nonfat solids end up in the buttermilk powder. The lower yield (0.99) is to compensate for generally lower buttermilk powder prices compared to NFDM prices and the higher costs associated with drying buttermilk powder compared to nonfat dry milk. While noting that Dairy Market News information indicates that buttermilk powder price discount relative to NFDM prices has narrowed in recent years, we acknowledge that the issue of the NFDM yield appears in need of additional study, but we are not supporting a change to the yield at this time.

Base Class I Skim Milk price

Proposal 13. NMPF proposes returning to the "higher of" Class I mover instead of the current "average of +\$0.74" mover. **Dairy Institute opposes Proposal 13.** Our opposition to this

proposal stems from the fact that it would make Class I hedging extremely difficult, if not impossible, for most Class I processors. Our Class I members feel that the ability to hedge Class I milk is becoming increasingly important for some growing market segments such as extended shelf life (ESL) products and food service. In many of these segments, our members are competing with other beverages options that have an ability to offer fixed pricing so that their customers, retailers, and food service establishments, can plan pricing and promotion strategies more efficiently. Milk is at a competitive disadvantage to alternative beverages when our industry does not have the ability to effectively manage risk and offer fixed pricing to our customers. The current mover allows Class I processors to manage risk, while Proposal 13 would not.

Proposal 14. IDFA proposes an updated Class I mover that is the average of the Advance Class III and Advance Class IV skim milk prices PLUS the higher of either \$0.74/cwt. or an adjuster equal to the 24-month (August-July) rolling simple average difference between the Advance Class III and Advance Class IV skim milk prices. **Proposal 15.** The Milk Innovation Group (MIG) proposes to retain the current average of formula for the Class I skim milk price and update the adjuster monthly using a 24-month lookback with a 12-month lag (that is, the preceding 13-36-month period). **The Dairy Institute supports both Proposal 14 and Proposal 15.** Either proposal would align Class I milk prices more closely than the current mover with prices generated under the old “Higher of” formula. Both proposals would allow Class I handlers to hedge and provide a fixed price to customers who desire it.

Proposal 16. Edge Dairy Farmer Cooperative (Edge) proposes changing the Class I skim milk price to the announced Class III price plus an adjuster. The adjuster would be a 36-month average (August-July) of the monthly differences between the “higher of” Advance Class III/IV skim milk price and the Class III skim milk price. While this proposal could allow for Class I hedging using Class III futures contracts, Dairy Institute’s Class I processor members are concerned that the lack of advanced Class I pricing would be problematic. To be able to offer customers a pricing in advance of the month, the proposal might require hedging of all Class I milk, even standard HTST retail accounts where milk monthly Class I milk price changes are

currently passed through to retail customers. Alternatively, the proposal could require Class I processors to true-up monthly with customers once the regulated price is announced after the milk has already been sold. It is unclear whether customers would accept this change, and Dairy Institute members are not ready to support such a change.

Proposal 17. Edge proposes a second alternative for changing the base Class I skim milk price to use the “higher of” announced Class III or Class IV skim milk price. **Dairy Institute opposes Proposal 17.** The lack of advance pricing and return to the ‘higher of’ methodology will not allow for Class I hedging, and the cost of milk would be unknown when it is sold to the retail customer.

Proposal 18. AFPF proposes elimination of advance pricing on all Class I and Class II skim. It would change the Class I mover to the “higher of” the announced Class III or Class IV price. **The Dairy Institute opposes Proposal 18** as it suffers from the same shortcomings as Proposal 17.

Class I and Class II Differentials

Proposal 19. NMPF proposes to increase the Class I differentials in all locations by varying amounts, with increases around the country higher by an average of approximately \$1.50 per cwt. **Dairy Institute opposes Proposal 19.** Dairy Institute does not believe the Class I price differential increases as proposed by NMPF are warranted. In California, the proposal would increase Class I differentials by \$0.70 to \$1.10 per cwt depending on the county. It appears that the proposal would do little to incentivize the movement of milk to Class I plants as Class I price gradients have not changed substantially. The proposal appears to be designed more for producer price enhancement than for facilitating orderly movement of milk to Class I markets. To the extent that the cost of bulk milk transportation has increased, those additional costs are probably being paid in the form of higher transportation charges that cooperative milk suppliers charge their Class I customers. Class I differential changes are historically contentious because they can have substantial competitive impacts with winners and losers. The additional Class I revenues available

to federal order milk pools will further disadvantage producer cooperatives that own manufacturing plants and that are already contending with inadequate make allowances. Conversely, cooperatives that own Class I plants or that are primarily milk suppliers to Class I processors will benefit from the higher Class I prices as well as the elevated prices for other classes that result from make allowances that are too low.

Proposal 20. MIG proposes to eliminate the base Class I differential of \$1.60 per cwt. It is arguing that that the base differential is no longer needed to attract milk to Class I plants in milk surplus areas. Only location differentials would be added to the Class I mover to establish a particular county's Class I price. **The Dairy Institute is neutral on Proposal 20.**

Proposal 21. AFBF proposes increasing the Class II differential from its current value of \$0.70 per cwt. to a new value of \$1.56 per cwt. **Dairy Institute opposes Proposal 21.** The AFBF proposal appears based on the notion that plants would be willing to pay as much as \$1.56 above Class IV prices before they are incentivized to use ingredients rather than milk. Dairy Institute believes that Proposal 21 will result in NFDM being substituted for Class II skim in the production of Class II products. Therefore, the proposal should not be adopted.

AMS Proposal

Proposal 22. USDA proposes that it be allowed to make any changes as may be necessary to make the respective individual marketing orders conform with any amendments that result from the hearing. Dairy Institute understands the need to make conforming changes to the individual order language, however we can neither support nor oppose these changes until we know what they are.

This concludes my testimony on behalf of Dairy Institute of California. Thank you for the opportunity to testify today.