

ALTERNATIVE FEDERAL ORDER MINIMUM PRICING OPTIONS

NOTE: USDA DOES NOT HAVE A POSITION OR PREFERENCE FOR ANY OPTION LISTED.

Butter-Powder Formula to Calculate the Class IV Price and as the Class III Price Mover

The fundamental components of the value of milk are butterfat and nonfat solids. The processes and technologies used to manufacture butter and nonfat dry milk (NFDM) are similar across the country, with less variability in yield and processing costs than exhibited by the more varied cheese manufacturing sector. Class III milk prices are calculated by converting the value of protein in NFDM to its value in both cheese and whey.

Limit Pool Access to Milk for Fluid Use – Establishment of Competitive Pay Price from Non-pool Milk

The marketwide pools of each of the orders could be tightened to include only those dairy farms directly servicing the Class I market. By tightening the performance requirements of the orders, a competitive pay price could be developed from prices paid for deliveries to unregulated outlets. Unregulated buyers of milk would be required to submit payroll information that would provide the data necessary to calculate a competitive pay price. This competitive pay price would set Class III and IV prices for the month and some variation would serve as the Class I mover for the following month.

Manufacturing Grade Milk Price Series as a Basis for a Competitive Pay Price

The National Agricultural Statistics Service (NASS) conducts a monthly survey of manufacturing grade milk prices from plants in seven states and publishes a monthly manufactured grade milk price in the *Agricultural Prices* report. The Dairy Programs 2009 Manufactured Milk Program participating States include the seven in the NASS sample as well as nine more – sixteen States in total. From 1992 to 2002, the number of manufacturing grade producers declined 74 percent and continues to decline. However, an estimated 250 plants across the United States (U.S.) still purchase manufacturing grade milk. These plants could be surveyed and an average U.S. price for manufacturing grade milk reported. Such a price could be used to develop a competitive pay price that sets Class III and IV prices for the month and some variation would serve as the Class I mover for the following month.

Competitive Pay Price from Unregulated Portion of Idaho and Parts of the Former Western Order

Cheese production is prevalent in Idaho and about two-thirds of the milk is used for manufacturing. Farm milk pricing is driven mainly by cheese yields. A surveyed price of milk used for manufacturing in Idaho could be used to develop a competitive pay price. This competitive pay price would price manufactured milk and serve as the Class I mover for the following month.

Use of Chicago Mercantile Exchange Values to Determine Class III and Class IV Prices

The Chicago Mercantile Exchange (CME) currently offers several contracts for milk and dairy products. Two types of butter and nonfat dry milk (NFDM) futures contracts are traded, one type is settled through physical delivery and the other is cash settled. The cash settled futures contracts for butter, NFDM and dry whey settle against National Agricultural Statistics Service prices. It seems that a similar futures contract for cheese could be established. Spot markets operate for cheese, NFDM, and butter. Class III and Class IV milk futures contracts are cash settled against Agricultural Marketing Service announced prices. Potentially, CME prices could be utilized instead of NASS prices in the product price formulas. Or, the CME could utilize formulas to generate Class III and Class IV prices that are used to close futures contracts and USDA could use these values as Class III and Class IV prices and serve as the Class I mover.

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Pooling Class I Differentials Only

Class I differentials vary by location and implicitly assume that the market determines a price for milk used in manufacturing. Pooling only the Class I differentials would allow eligible producers, those meeting the specific criteria, to share in the additional value associated with fluid uses. No other prices would be computed and Market Administrators would enforce producers' receipt of their shares of the available Class I dollars.

Pooling Class I Differentials Only in a Designated Region

As a variation of pooling Class I differentials only in each order, Class I differentials could be pooled in a designated region and the resultant competitive pay price could be used to set manufacturing milk prices for all other Federal orders. Pooling only the Class I differentials for a single order could allow eligible producers on that order to share in the additional value associated with fluid uses while providing a base for the determination of a competitive pay price for all other orders. Buyers of milk in the designated order would be required to submit producer payroll information and the competitive pay price would be derived from the pay prices received by producers whose milk was not received at Class I plants.

California Manufacturing Prices

As of 2007, California represented 55.8 percent of the NFDM, 32.5 percent of the butter, 20.6 percent of the cheese and 8.3 percent of the dry whey produced in the United States. California uses product price formulas to set minimum State order prices, employing Chicago Mercantile Exchange (CME) prices for butter and cheese. Make allowances are updated through a hearing process using California plant manufacturing cost data collected and released by the California Department of Food and Agriculture. This proposal would utilize the California Class 4a and 4b prices, without the California-to-Chicago FOB adjustment, as the Class III and Class IV prices and a variation would be used to establish advanced Class I and II prices.

Estimating a Competitive Pay Price from a Fully Regulated Market

Removal of the estimated impact of Federal order participation from the producer pay prices yields actual pay prices that can be used to establish minimum prices across all Federal orders. To compute the competitive pay price, the producer gross pay is reduced by the Class III component and somatic cell value. The remaining value is summed across all pooled producers and the Producer Price Differential (PPD), adjusted for location, is subtracted. The remaining value represents premiums paid to producers (i.e. the competitive value of milk above the Class III price) that, when added to the Class III price, results in a competitive pay price at 3.5 percent butterfat. This competitive pay price would replace product price formulas and a variation would serve as the Class I mover.

Deregulation of Specified U.S. Counties to Establish a Competitive Pay Price

The level of competition in a specified geography can be approximated using a technique known as the Herfindahl-Hirschman Index (HHI), a measure of concentration. HHI values could be used to identify areas of significant competition for milk. Once identified, these areas could be deregulated and serve to provide data on prices discovered in a competitive market setting. This competitive pay price would replace product price formulas and a variation would serve as the Class I mover.

Electronic Auction as a Means of Price Discovery

The use of auctions to buy and sell products is commonplace for United States agricultural commodities. The sales prices of auction markets are regularly monitored and reported and are a valuable source of pricing information for some agricultural products. At present, *Dairy.com* provides an electronic auction environment for dairy. It is primarily utilized for the trading of cream. In New Zealand, Fonterra has operated an electronic auction platform since July 2008. Fonterra's auction environment is primarily utilized for the sale of dry milk products. Because electronic dairy auctions are in their infancy, significant development efforts would be required to determine if this is even a viable price discovery possibility for further consideration.