

What is Happening With the Federal Orders?

The Federal Order system has been constantly changing since its inception in 1937. Originally, there were three classes of milk, today there are four. In 1960, there were 80 different orders that have now consolidated to 10. The most recent major reform was implemented January 1, 2000, installing multiple component pricing in seven of the eleven federal orders, accomplishing a major victory in equitably pricing producer milk.

So what are the next possible adjustments to the Federal Order system and what can producers expect?

In this article, National All-Jersey Inc. (NAJ) staff will explore several key factors: Proposed changes to make allowances and pricing formulas; possible order suspension; and how western producers are doing without a Federal Order.

Make Allowances

Manufacturing, or make, allowances are set amounts subtracted from the market of cheddar cheese, butter, nonfat dry milk, and dry whey used in producer price calculations. These deductions are intended to help dairy processors cover the cost of converting fluid milk into final products.

Current make allowance levels were determined in 2000, using cost of production data from 1997 through 1999.

Agri-Mark and other cooperatives petitioned the United States Department of Agriculture (USDA) to update these allowances to reflect the increased cost of production since 2000.

After two hearings, USDA's Dairy Programs announced the revised make allowances in November 2006. As shown in Table 1, the make allowance for whey had the greatest increase while the amount for cheese was barely raised.

What do these new levels mean for producer milk checks? USDA estimates the Class III price will drop 25 cents per hundredweight and NAJ predicts high solids milk will lose 26 cents per hundredweight.

As with all changes to the Federal Order system, producers in each order must vote to either accept the orders as changed or eliminate the order completely. The proposed new make allowances were accepted in all 10 orders, but just barely in the Upper Midwest. If only one cooperative had voted differently, that order would have been terminated.

Dairy Programs originally intended the new make allowances to be implemented for February 2007's advanced Class I and II prices, but a group of producers filed a lawsuit to delay the action. They argued

USDA did not follow proper procedures during the hearing process and did not take into account all evidence presented. A processor group then filed a similar brief regarding the hearing process. The new make allowances were implemented on March 2, 2007.

Table 1: Make Allowance Tentative Decision
All prices in cents/pound

	Current	New	Increase	% change
Cheddar	16.50	16.82	0.32	1.9%
Butter	11.50	12.02	0.52	4.5%
NFDM	14.00	15.70	1.70	12.1%
Dry whey	15.90	19.56	3.66	23.0%

Class I and II

In response to the make allowance changes, the National Milk Producers Federation (NMPF) called for a hearing to update Class I and II price formulas.

While they acknowledged processors' costs have increased, producers' costs of serving the fluid market have increased as well. The proposed revisions would add 77 cents to the announced Class I price. This change would be most advantageous for producers in orders with high Class I utilization. For others, in orders with a high percentage of manufacturing, the blend price received would hardly be impacted.

The hearing on this issue was held in December 2006 and a decision has not yet been announced.

Class III and IV

Dairy Programs has also accepted proposals revising the pricing formulas for Class III and IV milk.

NAJ entered a proposal to value whey on a protein basis instead of the other solids basis currently in use. This is because whey is being purchased for its protein content, not its lactose. This proposal is revenue-neutral for milk with standard components at 6 cents and could add 10 to 30 cents for high solids milk.

Other proposed changes include updating the formula's butterfat recovery percentage, eliminating the use of a barrel cheese price in the formulas, and incorporating Chicago Mercantile Exchange (CME) prices into the formulas.

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The initial hearing for these proposals was held in late February and a continuation will be held in early April.

Life Without An Order

In 2004, producers in the Western Order (covering Utah and parts of Idaho, Wyoming, Nevada, and Oregon) voted to not accept changes to the Federal Order system and the order ceased to exist.

So how are things without a federal order?

“Producers are still being paid based on components or cheese yield and prices are comparable to the nearby Northwestern Federal Order,” said former NAJ president, William Mason of Buhl, Idaho.

“Independent shippers that had been riding the pool were the ones hurt the most,” continued Mason, the current president of Magic Valley Quality Milk Producers Cooperative.

Life without the federal order is pretty much the same, although producers could suffer from a lack of infrastructure.

“We could run without an order if there was a government body to regulate the testing, to keep everyone honest,” says Mason.

When the order was in place, milk from areas outside the Western states was often shipped into the order to receive the regulated minimum price. Now, without the order, processors are responsible for pricing the milk they receive.

Mason is concerned about cheese yield formula manipulations and inaccurate component testing that could be resulting from a lack of third-party regulation. There has been some talk of re-establishing a Western Federal Order, which would require petitioning Dairy Programs and going through the hearing process.

While federal orders do supply auditing, testing, and reporting functions, Mason feels they still place too much emphasis on Class I milk while the industry moves towards cheese and dry ingredient manufacturing.

“We might be better off if there was an order, but it would need different rules than there were before.”

Southeast Orders

Is there a way to keep the auditing and structural functions of the federal order system without the pricing and pooling functions?

That’s just what a producer group called Dairy Cooperative Marketing Association, Inc. (DCMA) is proposing in the southeast United States.

DCMA is working in the Appalachian, Florida, and Southeast orders (Orders 5, 6, and 7) to develop a proposal that would suspend the pricing and pooling of those orders and instead allow the cooperatives to work together as a single agency to price producer milk.

The proposal would eliminate classified pricing; all milk would be priced the same, regardless of which products it is used for. Plants would be charged the value of producer milk based on the cost of milk in reserve supply areas, plus what it would cost to transport that milk to the southeast.

The proposal would keep the auditing, testing, and reporting functions of the order, explained Mason making it easier to vote the order back in, if things don’t work out.

Dairy Programs has indicated a willingness to consider these concepts, and the next step for DCMA is to outline the specifics of their proposed pricing formula.

Summary

The federal order system has undergone major reforms since its original inception in 1937. With the low milk prices and high costs of production of the past year, USDA’s Dairy Programs is busy working through proposed changes to just about every area of the minimum price formulas.

Some orders are barely surviving each producer vote, and others may soon be suspended or eliminated. If orders with high manufacturing were eliminated, plants in those areas would still likely use some form of component pricing, having little effect on Jersey producers.

The significant impact could be felt in areas with high fluid utilization if they revert back to fat-skim pricing, which would eliminate the incentive for non-Jersey producers to switch to Jersey genetics for efficient component production.

Federal orders provide stability and regulated minimum prices, but also have restrictions and formulas that need to be changed. National All-Jersey Inc. is continually monitoring all the above situations and what they could mean for producers of high solids milk. Watch the Weekly Market Update and Equity Newsletters for current information and feel free to contact the NAJ staff at 614/861-3636 with any questions or requests for additional information.