Testimony of
The California Dairy Campaign (CDC)
Before the United States Department of Agriculture (USDA)
Federal Milk Marketing Order Hearing in Carmel, Indiana
August 2023

Hearing officer and members of the panel, my name is Lynne McBride. I serve as Executive Director of the California Dairy Campaign (CDC). Founded over 25 years ago, CDC is a grassroots organization representing dairy farmers throughout California. Our office is located in Turlock, CA, in the heart of the Central Valley of California. The California Dairy Campaign Board of Directors voted to approve a proposal to add mozzarella to the Class III pricing formula during our annual meeting in Hanford, CA, on January 12, 2023. CDC is a member organization of the California Farmers Union (CFU), a state chapter of the National Farmers Union, a farm organization representing more than 230,000 farmers and ranchers nationwide.

I would like to begin by speaking about the Special Order of Business passed during the National Farmers Union Convention in San Francisco, CA, earlier this year. California Dairy Campaign and California Farmers Union leaders worked with dairy farmers from across the country to finalize the NFU special order titled "FAMILY FARMING and DAIRY POLICY REFORM 2023 SPECIAL ORDER OF BUSINESS."

"Although milk prices paid to dairy farmers improved in 2022, feed prices and input costs reached record highs, reducing dairy farm profitability. Since 1992, the number of US dairy farms has decreased by 77 percent or more than 103,577 farms due to low dairy farm margins**.** To reduce dairy farm closures and improve the outlook for US dairy farmers, we call on Congress to pass a farmer-led incentive-based milk production growth plan to match milk supply with profitable market demand.

As a result of widespread market concentration and consolidation, dairy farmers have little, if any, choice about where to ship their milk, further depressing milk prices paid due to a lack of competition. The federal milk marketing order system was set up in the 1930s to establish **minimum prices** paid to dairy farmers and guard against non-competitive and predatory practices of milk handlers. Prior to the establishment of the federal milk marketing order system, dairy farmers around the country were at the mercy of milk handlers who controlled milk prices paid. Because milk is a highly perishable product that must leave the farm each day, federal milk market order regulations are vital to ensure dairy farmers are paid a minimum price for the milk they produce.

The last federal order hearing to consider significant changes in the pricing formulas occurred 15 years ago, and the dairy market has grown dramatically more concentrated since then, making federal order minimum milk pricing more critical than ever before. Dairy farmers do not have the ability to change milk handlers, given the level of consolidation and concentration that exists today. Therefore, minimum milk prices must ensure that dairy farmers are paid a price that reflects the value of all milk and dairy products sold to sustain dairy farmers and foster a secure food supply for consumers." The special order of business later supports "Reforming all Class formulas to reflect the value and volume of all dairy products sold in the market today as current milk pricing formulas fail to reflect the actual market value of dairy products, particularly higher moisture, and higher value cheese products." (Exhibit 7)

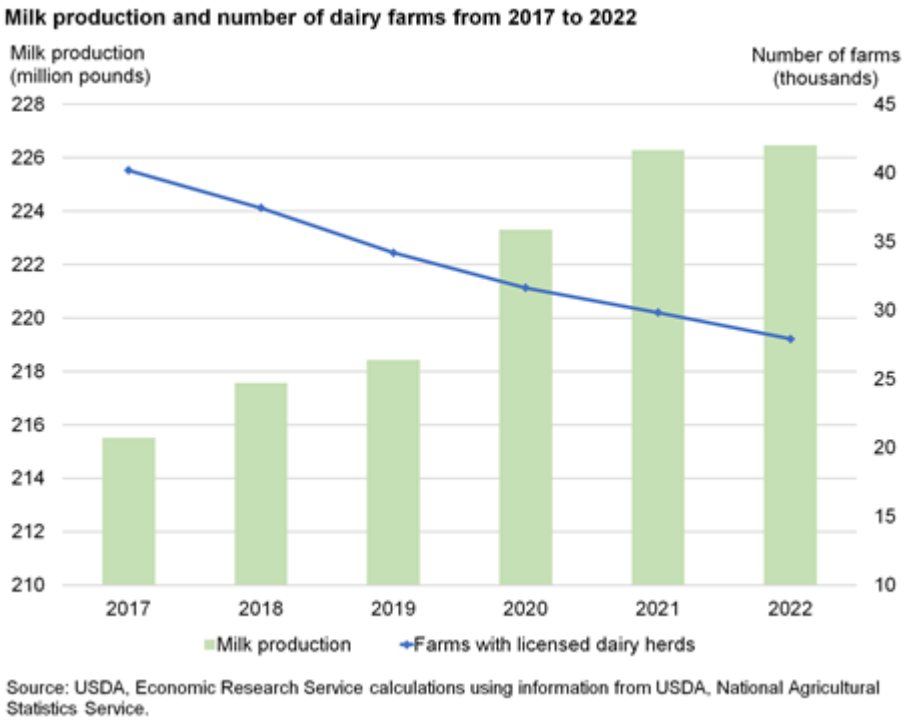
Federal milk marketing orders (FMMOs) were established to stabilize the milk market and help equalize the market power of dairy farmers with dairy processors. In effect, the federal milk marketing orders system exists to protect dairy farmers from dairy processors. We consider it important to recall the importance of federal orders to dairy farmers throughout history as proposals for changes are considered.

Before moving onto the specifics of our proposal, it is important to consider the crisis dairy farmers face today due to milk prices falling well below production costs. The United Department of Agriculture (USDA) National Agricultural Statistics Service (NASS) reporting indicates that the number of dairy farms has dropped by more than 60 percent since 2000. Many leaders in our organization have been forced to sell their entire dairy operations because milk prices paid fail to come close to covering the average cost to produce milk today.

California Dairy Campaign publishes a monthly milk pricing survey of approximately 40 dairy producers who report their prices, including milk components each month, from a variety of milk handlers. Although the numbers are still coming in, it is evident that the net price paid will total approximately $14 per cwt, an abysmally low price. Our latest pricing survey shows milk prices are well below average production costs. In July, the Statistical Uniform Price (SUP) in California totaled $15.53 per cwt while the average cost of production in our state totals more than $23 per cwt, according to the latest United States Department of Agriculture (USDA) Economic Research Service (ERS) Milk Cost of Production Estimates. Nationally, the average cost of production totals more than $27 per cwt according to the same USDA ERS estimate.

In short, multigenerational dairies are going out of business in droves due to depressed milk prices, particularly Class III prices. Our monthly milk pricing survey shows how Class III shippers are paid significantly less than dairy producers shipping to handlers of other classes. Although Class III prices rose significantly in 2020, they have remained below Class IV prices for a prolonged period. As we sit here today discussing the specifics of milk pricing formulas, dairy farmers around the country are facing economic ruin due to high input costs and milk prices comparable to those paid decades ago. Dairy farmers want to get off the roller coaster of volatile and chronically depressed milk prices. An increase in

the manufacturing cost allowance or make allowance as called for in multiple proposals before this hearing will exacerbate the crisis dairy farmers face.



Since it began, we have participated in Dairy Together, a nationwide effort of dairy farmers from across the country calling for a nationwide, farmer-led, incentive-based dairy growth management plan that would match milk production with profitable market demand. An effective growth management plan would improve the outlook for dairy farms nationwide. We understand and appreciate that it is the role of Congress to change the direction of federal dairy policy to establish incentives for milk production to more closely align with market demand. However, during this hearing, much time will be devoted to proposals that would increase the manufacturing cost allowance or make allowance. An increase in the make allowance will make our nationwide supply-demand imbalance even worse than it is today.

In the absence of a dairy growth management plan, today, we have a patchwork across the country of plants that send strong signals to dairy producers about how much milk to produce and some that don't. That patchwork is failing; the evidence is the volatile and chronically depressed milk prices paid to dairy farmers nationwide. An increase in the make allowance will make plants less responsive to changes in market conditions and less inclined to send signals to dairy farmers about how much milk to produce. We oppose any increase in the manufacturing cost allowance proposed for this hearing.

Milk handlers need to look further up the food chain to cover their costs, not saddle dairy producers with higher manufacturing cost allowances. Even worse, one proposal aims to update the manufacturing cost allowance more frequently. We had a system in California

that included frequent updating of make allowances, and it led to the growth of dairy processing and increases in milk production that was not based on market demand but instead was a direct result of generous make allowances. All the extra milk production and processing in California depressed milk prices nationwide, and we oppose a similar attempt proposed at this hearing to ramp up make allowances routinely. The current voluntary unaudited manufacturing cost surveys relied on to determine manufacturing cost allowances represent a small fraction of the manufacturing plants nationwide. We oppose any attempt to increase the make allowance based on these unreliable cost studies. In addition, the current manufacturing cost allowances include a return on investment. Dairy farmers have no similar guaranteed return on investment enjoyed by processing plants. The ROI category is estimated to cost dairy farmers nationwide hundreds of millions of dollars annually and should be removed from the manufacturing cost allowance calculation.

Class III Price Formula Undervalues Milk

Our proposal seeks to change the Class III pricing formula to reflect the value of the cheese market today more accurately. The federal orders calculate milk prices based on end product prices, and it is essential to include the largest cheese category in the end product price calculation. Our proposal would add a mozzarella price to the protein price included in the Class III price formula. Adding mozzarella to the protein price would make Class III pricing more reflective of the cheese prices paid and yields achieved today. The volume of mozzarella has now significantly exceeded that of cheddar, and the Class III price should be modified to reflect these market conditions.

According to the United States Department of Agriculture (USDA) Dairy Products 2022 Summary published in April this year, Mozzarella production totaled 4,497,175,000 pounds, while cheddar totaled 3,963,741,000 pounds. Total cheese production in 2022 totaled 14.1 billion pounds last year. Mozzarella has surpassed cheddar in total cheese production and should no longer be ignored in the federal order pricing formulas.

Today's Class III price is based on the price of cheddar cheese, which is produced in lower volumes than mozzarella. A 2007 General Accounting Office (GAO) Report concluded that the Chicago Mercantile Exchange (CME) was thinly traded and vulnerable to market manipulation. Prices paid on the CME have an outsized impact on the Agricultural Marketing Service (AMS) National Dairy Products Sales Report. Although CME sales account for less than one percent of all cheese sales, prices paid on the CME significantly impact the Class III price.

The CME spot market is where the last load of product is sold, and it serves as a marketplace of last resort. This market is limited to only a few traders and commercial firms. While the market sometimes moves without sales volume, the CME greatly influences the price for all cheese and butter across the country because these classes impact all milk prices paid to dairy farmers. Unfortunately, this failing milk pricing system has resulted in dairy farmers suffering economic losses due to volatile milk prices paid that fail to cover average farm operating costs. This hearing presents an opportunity to adopt our proposal and make the Class III pricing formula more market-oriented, accurately reflecting prices paid in today's market. (Exhibit 4)

FMMO Hearing 2000 – Mozzarella Ignored in the Pricing Formula

During the federal milk marketing order hearing in Virginia in 2000, California Dairy Campaign (CDC) Board Member Joaquin Contente, a dairy producer from Hanford, CA, raised the issue of the importance of mozzarella to calculate the Class III price. During his testimony, he questioned Dr. David Barbano about mozzarella, who confirmed at that time that mozzarella was being ignored in the federal order pricing system. (Exhibit 6)

Although mozzarella now exceeds cheddar cheese production, no change has been made in Class III to reflect the higher value and higher volume mozzarella market. Since 2000, the demand for mozzarella cheese has grown dramatically. According to a recent HTF Market Report, the mozzarella cheese market is expected to double its revenue size due to strong and steady growth. Despite the higher production of mozzarella cheese and the growth in this cheese variety that is expected to continue, Class III prices ignore this important and growing segment of the cheese market. (Exhibit 3)

Our proposal seeks to add mozzarella to the National Dairy Products Sales Report (NDPSR) so that it can be included in the protein calculation of the Class III price. The National Dairy Product Sales Report (NDPSR) is intended to reflect basic commodity products and should include mozzarella. We consider it essential that more dairy products are part of the mandatory dairy pricing survey to improve transparency in the pricing of milk paid to dairy producers.

Mozzarella Specifications

According to information from the United States Department of Agriculture (USDA), mozzarella has four main specifications. We propose incorporating mozzarella specifications based on the highest production to determine the appropriate moisture and fat content for a standardized mozzarella. Until now, there has been no standard specification for mozzarella cheese. USDA collects data about mozzarella cheese production and can use that information to determine moisture and fat content to establish one. (Exhibit 9)

Mozzarella production is the largest category of cheese produced today and deserves a standard specification of its own determined by the volume of mozzarella produced today. USDA publishes the volume of mozzarella in the National Agricultural Statistic Service (NASS) reports, and the specifications of the cheese should be made available publicly and utilized in the protein price in the Class III formula. We propose adding mozzarella to the protein price based on the Van Slyke cheese yield formula, which effectively determines cheese yields for mozzarella. (Exhibit 8)

The end-product pricing formulas should reflect end-product prices in the market today. Mozzarella is the most significant segment of the cheese market, so it should be incorporated into the Class III end-product pricing formula. At our request, USDA has provided an extensive series of information about mozzarella prices paid titled, "U.S. Mozzarella Production and Wisconsin Wholesale Price, 2000 to 2023." The price series documents the higher and more stable wholesale price paid for mozzarella over more than 20 years. For example, when dairy producer prices, including Class III, dropped precipitously in 2009 and 2010, mozzarella prices remained stable. If mozzarella had been

added to the Class III pricing formula back then, it would have improved milk prices paid and fostered more orderly marketing of milk nationwide. (Exhibit 2, 3)

Concentration and Consolidation Increasing

Our dairy farmer members are concerned about how concentration affects price transparency in dairy pricing. It has undermined price discovery because fewer buyers and sellers are in the market today. (Exhibit 5)

According to the Congressional Research Service (CRS) Report from 2010 titled *Consolidation and Concentration in the U.S. Dairy Industry*, "Typically, markets work more efficiently when there are many "observable" transactions that provide sufficient information to all market participants about demand, supply, and prices. The move within the dairy industry to a more integrated market, with closer ties between various market players such as custom contracts or other pre-arranged transactions, results in fewer trades of products on the cash or "spot" market. In years past, these sales would account for a greater share of market transactions and provide a good measure of current prices. The primary spot market for dairy is located at the Chicago Mercantile Exchange (CME), where cheese, butter, and nonfat dry milk are traded. Actual quantities traded are quite small, but prices determined by buyers and sellers at this market are used to establish wholesale price contracts across the country, subject to premiums and discounts for factors such as quality and transportation. Wholesale dairy product prices are then used to set monthly minimum prices by USDA that milk handlers must pay for farm milk under federal orders.

Some dairy producer groups believe that the CME is an inadequate pricing mechanism because of perceptions that the market is too thinly traded, lacks transparency and sufficient oversight, and creates a highly volatile market that adversely affects producers. The GAO study concluded in 2007 that "certain market conditions at the CME spot cheese market, including a small number of trades and a small number of traders who make a majority of trades, continue to make this market particularly susceptible to manipulation." We agree that the CME is an inadequate pricing mechanism because it is thinly traded and vulnerable to manipulation. Adding mozzarella to the protein pricing formula would work to counterbalance the impact of the thinly traded CME market.

Profitability Further Up the Food Chain

According to the Congressional Research Service (CRS) Report, *Farm-to-Food Price Dynamics*, the time lags in retail price response to farm price changes are generally months long, even for perishables like milk. Another characteristic of food markets is that adjustments in retail prices from higher farm prices occur faster and with greater pass-through to the consumer than adjustments to decreases in farm prices, an economic phenomenon often referred to as "sticky" retail food prices. Retail prices follow commodity prices upward rapidly but fall back only slowly and partially when commodity prices recede. The CRS report concluded that a "disconnect" exists between farm and retail prices of agricultural products. There is profitability further up the food chain, and dairy producers should not be required to pay more in manufacturing cost allowances to cover plant costs. The profitability further up the food chain ensures that any improvement in minimum milk prices paid to dairy farmers will not impact consumer prices.

Support for other proposals:

Proposal 1: The National Milk Producers Federation Proposal to amend the milk component factors in the Class III and Class IV skim milk pricing formulas.

Proposal 4: The American Farm Bureau Federation (AFBF) proposal to add 640-pound Cheddar cheese blocks to the protein price formula.

Proposal 5: The American Farm Bureau Federation (AFBF) proposal to add unsalted butter to the butterfat and protein calculation.

Proposal 13: The National Milk Producers Federation proposal to amend the base Class I skim milk price in all Federal orders to return to the "higher" of the Class III and Class IV Advanced Skim milk pricing factor.

Proposal 19: The National Milk Producers Federation Proposal to update the Adjusted Class I differentials.

Proposal 21: The American Farm Bureau Federation Proposal to update the Class II differential.

As stated before, the California Dairy Campaign opposes increases in the manufacturing cost allowances included in proposals 7 by the National Milk Producers Federation, 8 by the Wisconsin Cheese Makers Association, and 9 by the International Dairy Foods Association.

In conclusion, our proposal aims to improve overall dairy price transparency by expanding the United States Department of Agriculture's mandatory price reporting system to add additional products like mozzarella. Given the concentration and consolidation that exists, minimum prices paid by the federal milk marketing order system are critical to ensure dairy farmers are paid prices based on current market conditions. In addition, we oppose an increase in the manufacturing cost allowance because it will further reduce milk prices paid to dairy farmers who are already enduring milk prices well below production costs. If anything, make allowances should be lowered to eliminate return on investments because farmers do not have a similar guarantee or any certainty their costs will be covered in minimum milk pricing formulas. On behalf of the California Dairy Campaign (CDC), I thank you for the opportunity to testify today. I would like to request the ability to submit additional written testimony on a range of subjects important to dairy farmers to the hearing panel.