TESTIMONY OF THE INTERNATIONAL DAIRY FOODS ASSOCIATION WITH RESPECT TO SURVEYED COMMODITY PRODUCT PROPOSAL 3 AUGUST-SEPTEMBER 2023 FEDERAL MILK ORDER HEARINGS
DOCKET NO. 23-J-0067; AMS-DA-0031

This testimony is submitted on behalf of the International Dairy Foods Association (IDFA) with respect to Proposals 3. This Proposal would eliminate the cheddar cheese 500-pound barrel price series from the commodity products that are surveyed as part of the formula for setting minimum milk prices.

IDFA represents the nation's dairy manufacturing and marketing industry, which supports more than 3.2 million jobs that generate $49 billion in direct wages and $794 billion in overall economic impact. IDFA's diverse membership ranges from multinational organizations to single-plant companies, from dairy companies and cooperatives to food retailers and suppliers, all on the cutting edge of innovation and sustainable business practices. Together, they represent most of the milk, cheese, ice cream, yogurt and cultured products, and dairy ingredients produced and marketed in the United States and sold throughout the world.

As buyers and processors of milk, the members of IDFA have a critical interest in these hearings. Most of the milk bought and handled by IDFA members is purchased under the Federal milk marketing orders promulgated pursuant to the Agricultural Marketing Agreement Act of 1937 (the "AMAA").

I am Mike Brown, Chief Economist for IDFA since January 2023. I have testified on other proposals earlier in this hearing, and at that time described my professional and educational background. My testimony now will address Proposal 3.

Since January 2000, federal milk marketing orders have utilized the price of finished products to determine the minimum milk prices that must be paid to farmers,

through a mechanism commonly referred to as a "product price formula." Oversimplifying slightly, a product price formula sets the minimum price that farmers must be paid for their milk (at least by proprietary handlers) as the price handlers receive for their finished products (cheddar cheese, dry whey, butter and nonfat dry milk) minus the costs handlers incur in turning farm milk into those finished products (commonly referred to as the "cost of manufacture" or the "make allowance"). In performing this calculation, USDA must make assumptions as to how much of the finished products can be made from a given quantity of milk (the "yield factors").

Accordingly, step one in the formulas by which USDA sets minimum price for milk used to make Class III and IV products starts with a survey of the price paid for specified manufactured dairy products. Proposal 3 would change that step in the process, by eliminating one of the products whose price is included in the price surveys.

For the reasons I will now explain, Proposal 3 should be rejected.

Class III products consist principally of cream cheese and other spreadable cheeses, and hard cheese of types that may be shredded, grated, or crumbled. 7 C.F.R. 1000.40(c). In order to set the protein price component of the price of milk used to make Class III products, the orders since 2000 have in step one relied upon the weighted average of the U.S. average price for 40-lb. block cheddar cheese and the U.S. average price for 500-pound barrel cheddar cheese (38 percent moisture). 7 C.F.R. 1000.50(n)(1). These prices are obtained through a survey of: (i) the National Dairy Products Sales Report (NDPSR) of prices paid for 40-lb. block cheddar cheese; and (ii) the NDPSR for prices paid for 500-pound barrel cheddar cheese (38 percent moisture). Id. To be included in these Sales Reports, cheese must meet various criteria, including

age (no less than 4 days or more than 30 days on the date of sale); color (within a specified color range for 40-pound blocks; white for 500-pound barrels); and moisture content (no more than 37.7% moisture for 500-pound barrels). 7 C.F.R. 1170.8(a).

Proposal 3 would eliminate the cheddar cheese 500-pound barrel price series from the protein price formula used to price milk used to make cheese. Thus, the price survey would be limited to 40-lb. blocks.

Whether 500-pound barrel cheese should be included in the surveys is a question USDA has previously addressed, and on two separate occasions, resolved in favor of inclusion. IDFA believes that USDA's reasoning in reaching that conclusion was sound, and continues to be valid today.

When USDA in 1999 and 2000 was for the first time in the process of adopting product price formulas to set minimum milk prices, NMPF argued, as it does now, that the survey should be limited to 40-pound blocks. "NMPF urged that the barrel price not be included because barrels don't have uniform composition, and because the use of such prices would have the effect of unnecessarily reducing prices to producers." USDA, Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders, 64 FR 16026,16098 (Apr. 2, 1999).

Other industry participants disagreed, and USDA rejected NMPF's position, concluding that "including both block and barrel cheese in the price computation increases the sample size by about 150 percent, giving a better representation of the cheese market." Id.

An identical proposal to eliminate 500-pound barrels was subsequently advanced in connection with the hearings that led to the 2008 revisions to federal milk marketing

orders. Milk in the Northeast and Other Marketing Areas; Tentative Partial Final Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and Orders, 73 FR 35306, 35309 (June 20, 2008). USDA again rejected that proposal, concluding:

> This decision finds that retaining the cheese barrel price in the protein price formula is necessary to ensure that the protein price is representative of the national cheese market. The Class III product-product price formula needs to be as reasonably representative of the market for cheese that determines the value of milk. Record evidence reveals that barrel production in the NASS survey is often in excess of 50 percent of the total cheese volume surveyed. Eliminating the barrel price from the protein price formula would significantly and needlessly reduce the volume of cheese used in the Class III product price formula which could lead to protein prices that are not as representative of the national cheese market. Accordingly, Proposal 13 [to eliminate 500-pound barrels] is not adopted. Id. at 35328.

The reasons behind USDA's decision to include 500-pound barrels in the product surveys are equally valid today. First and foremost, volume sales of both forms of cheddar cheese remain very robust. In, 2022 reported NDPSR 40 pound cheddar block sales volume totaled 643.0 million pounds and 500-pound barrel sales were 701,415,050 pounds. USDA Datamart, Location: Products\Dairy\All Dairy\(DY_WK100) National Dairy Products Prices – Weekly Final Block and Barrel Cheese Prices

https://mpr.datamart.ams.usda.gov/. Thus, both forms play a substantial role in setting the market value of cheddar cheese, which is the goal of step one of the process of setting minimum prices for milk used for Class III purposes.

Eliminating 500-pound barrels would reduce by more than half the market pricing information upon which USDA currently and appropriately relies. In the words of USDA in 2008, "[e]liminating the barrel price from the protein price formula would significantly

and needlessly reduce the volume of cheese used in the Class III product price formula which could lead to protein prices that are not as representative of the national cheese market."

Both 40-pound blocks and 500-pound barrels are traded on the Chicago Mercantile Exchange (CME). It would make no sense for a product central to the commodity cheese marketplace to be so traded on the CME cash exchange, and yet not taken into account when the federal order system assesses the market value of cheddar cheese for purposes of setting minimum milk prices. Nor does IDFA or the many members they have discussed this issue with see any indication that the CME would cease trading 500-pound barrels simply because they were no longer included in the milk order pricing formulas.

40-pound blocks and 500-pound barrels are undoubtedly commodity products, with different functions, and the failure to include both in the pricing formulas would provide a distorted view of the commodity cheddar market. 40-pound blocks are typically sliced, diced, shredded or cut into smaller blocks and sold in its current form, while 500-pound barrels are typically further processed to create processed cheese and other cheese-flavored products. Critically, because 500-pound Cheddar barrels are further processed through melting, they can be stored at 28-29 degrees for up to 180 days for six months. Kroger has had success with this method on 40-pound organic cheddar blocks but I do not believe it is a wide industry practice. This storage method has been an active part of block inventory management for around a decade and has been widely adopted by both manufacturers and buyers of barrel cheddar. This process certainly allows 500-pound barrels to successfully balance seasonal inventories and provide a good market outlet for milk going into barrel cheese. This tool to balance cheese market

and demand further supported by the fact that facilities that can process 500-pound barrels tend to have more available capacity than 40-pound Cheddar block manufacturers and can thereby more readily serve as the necessary outlets for milk. These market functions can only be captured by including 500-pound barrels in the formulas.

The CME itself has noted the differences between the usage of blocks and barrels and how the market price for one does not capture the market conditions affecting the price of the other:

> Although blocks and barrels are both Cheddar cheese products, their end uses are diverse. Typically, manufacturers use block Cheddar cheese for chunks, loaves, shreds, and snack-sized natural cheeses, while barrels are often consumed in the processed cheese category. The different channels can create unique and often dissimilar demand cycles and trends as well as varied seasonal patterns.

CME Block Cheese Futures – A New Hedging Tool, available at: https://www.cmegroup.com/education/articles-and-reports/cme-block-cheese-futures-a-new-hedging-tool.html

The assertion that all cheese other than cheddar barrels are sold based on block prices is simply not the case. Even the witnesses for NMPF are not consistent with their estimates, ranging from 75% to 90%. From my personal experience there is a growing piece of the cheese market not priced on either the block or barrel market. More and more small cheese manufacturers are turning the NDPSR cheese price as their base for its simplicity in hedging. Others are using the Class III price for a cheese value base because it eliminates whey price volatility in the Class III price for plants with limited opportunities for return on their liquid whey. Some exporters are using the barrel price for setting export values in very competitive markets where the block price simply isn't

competitive. Using the barrel price for these products moves the milk solids overseas, and away from the CME in either block or barrel form.

Against this backdrop, eliminating 500-pound barrels would reduce the efficacy of the milk order pricing formulas. IDFA does not take that position because it results in any particular advantage to processors. Whether the 40-pound block price is higher or lower than the 500-barrel price varies year to year (once one adds $0.03 to the barrel price, as provided for in the milk order formulas). The following chart shows the cheese price when "all cheese," i.e., both 40-pound blocks and 500-pound barrels, are included, versus when only 40-pound blocks are used:

Comparisons of NDPSR Monthly Block Price With The NDPSR Weighted Average Cheese Price

YEAR	NDPSR Wtg Avg Block-Barrel Price	NDPSR Block Price	Block vs. Wtd Average	Percent Blocks
2009	$1.30	$1.29	-$0.01	52.6%
2010	$1.52	$1.51	-$0.01	54.6%
2011	$1.82	$1.81	-$0.02	54.3%
2012	$1.71	$1.70	-$0.01	52.2%
2013	$1.77	$1.76	-$0.01	52.6%
2014	$2.16	$2.14	-$0.01	54.8%
2015	$1.65	$1.64	-$0.01	56.0%
2016	$1.61	$1.59	-$0.02	56.3%
2017	$1.63	$1.65	$0.02	50.6%
2018	$1.54	$1.58	$0.04	48.4%
2019	$1.76	$1.78	$0.02	51.7%
2020	$1.92	$2.04	$0.12	49.1%
2021	$1.68	$1.73	$0.06	48.4%
2022	$2.11	$2.10	-$0.01	47.8%

Source: https://usda.library.cornell.edu/concern/publications/zs25x847n?locale=en

As shown, in most years since 2009, using only 40-pound blocks would reduce the surveyed cheese price and therefore reduce minimum milk prices to farmers. While that relationship shifted for a few years from 2017 through 2021, it shifted back in 2022. In

any event, these shifts reflect actual market conditions, and that is what product price formulas are designed to do.

NMPF Proposal 3 should be rejected for the same reasons it was rejected by USDA in 2000 and 2008. The barrel market is an important part of the supply-demand balance of the commodity cheddar sector of the cheese industry and needs to remain part of the NDPSR Monthly Cheese Price.