Agricultural Marketing Service

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Milk in the Northeast and Other Marketing Areas

Proposal 2 – Milk Composition

Opening Statement of Erick Metzger representing National All-Jersey Inc.

1. Introductory comments
    a. The objective of proposals should be to improve the accuracy of the price formulas thereby increasing uniform pricing among handlers and producers and reducing disorderly marketing.
    b. Current skim component factors 3.10% P, 5.90% OS, 9.00% NFS used in the Class III and Class IV skim milk price formulas do not accurately skim component content of average producer milk.
    c. Outdated skim component factors cause Class I skim values to be misaligned with manufacturing skim values, thereby valuing Class I skim less than manufacturing skim and disincentivizing milk from serving the Class I market.
2. NAJ Exhibit 1
    a. Annual skim components, MCP orders, 2014-2022
    b. The three-year average following 2016 closely mirrored 2016 annual average.
    c. The three-year average following 2019 did not meet NMPF minimum threshold of 0.07% NFS required to update skim component factors.
    d. The three-year average following 2020 did meet minimum threshold to update skim component factors. Updated factors of 3.29% P, 6.00% OS, and 9.29% NFS, would be used for milk marketed during 2022, 2023, 2024.
    e. By 2022 national average skim components were 3.39% P, 6.03% OS, and 9.41% NFS.
    f. The rate of skim increase in skim components is accelerating.

g. Can be expected to continue.
    i. Genetics
    ii. Production quotas and base/excess programs
    iii. Robotic milking

3. NAJ Exhibit 2
    a. Comparison of Class I, III, and IV Skim Values (at test) for 2021 and 2022.
    b. Demonstrates the misalignment between current Class I skim values and manufacturing skim values and how updated skim component factors restore alignment.
        i. 2021
            1. Class I skim value $10.83
            2. Class III skim value $11.13 (at test)
            3. Class IV skim value $9.83 (at test)
            4. Because Class III had the highest value, handlers opted to depool Class III.
            5. Update skim component factors would value Class I skim at $11.26, higher than either Class III or Class IV, incentivizing handlers to pool both Classes.
        ii. 2022
            1. Class I skim value $13.03.
            2. Class III skim value $11.36 (at test)
            3. Class IV skim value $13.40 (at test)
            4. Class IV had the highest value, handlers opted to depool.
            5. Updated skim component factors would value Class I at $13.55, higher than either Class III or Class IV, incentivizing handlers to pool both Classes.
        iii. Depooled milk has three consequences pertinent to these proceeding:
            1. Depooled milk increases nonuniformity of pries paid by handlers.
            2. Depooled milk increases nonuniformity of prices paid to producers.

3. Depooled milk is never available to serve the Class I market.

4. NAJ Exhibit 3
    a. Impact of updated skim component factors on Classes II, III, and IV in order 5, 6, and 7 from 2019-2022.
    b. Focused on 5, 6, and 7 because over 70% of milk provided data. Due to confidentiality restrictions, Order 131 data are based on order 124.
    c. 2019 Class II averaged 9.20% NFS
        i. Greater than current skim component factor of 9.00%
        ii. Less than proposed skim component factor of 9.24% (2017)
        iii. Current F/S price $8.24
        iv. NAJ proposal $8.46
        v. MCP comparison $8.40
    d. 2019 Class III averaged 3.22% P, 5.98% OS
        i. Greater than current skim component factors of 3.10% P and 5.90% OS.
        ii. Less than proposed skim component factor of 3.26% P. Equal to proposed OS factor of 5.98% (2017)
        iii. Current F/S price $8.48
        iv. NAJ proposal $8.87
        v. MCP comparison $8.77
    e. 2019 Class IV averaged 9.21% NFS.
        i. Greater than the current skim component factor or 9.00%
        ii. Less than the proposed skim component factor of 9.24% (2017)
        iii. Current F/S price $7.79
        iv. NAJ proposal $8.04
        v. MCP comparison $7.97
    f. The years 2020 through 2022 showed similar outcomes.
    g. Skim components exceeded current skim component factors.
    h. Current factors priced Classes II, III, and IV below MCP value.

i. NAJ updated factors price milk above MCP value, but updated factors more closely represent actual components than current factors.

j. Don't let perfect be the enemy of good. Updated skim component factors make the skim price formulas more accurate.

5. NAJ Exhibit 4

a. Negative Producer Price Differentials in Federal Milk Marketing Orders: Explanations, Implications, and Policy Options – Working Paper 21-01, April 13, 2021, Marin Bozic and Christopher A. Wolfe

b. Producer price differential (PPD) = difference between total handler obligations to the pool and total component value of milk

c. When manufacturing milk carries greater value than pool average milk, the higher value manufacturing milk is induced to disassociate from the orders (depooling).

d. Class I milk does not have the option to depool.

e. Class I price is based on manufacturing milk prices, plus a Class I differential, which, in theory, should value Class I milk higher than manufacturing milk and discourage depooling.

f. Working Paper 21-01 examined six reasons and trends why manufacturing milk can be valued higher than Class I milk.

g. One reason was the difference between pooled skim value of Class I compared to pooled skim value of manufacturing milk.

h. Class I skim only contributes 3.10% protein, 5.90% other solids, and 9.00% nonfat solids to pooled revenue. However, if Class I skim contains components greater than these standards, Class I skim can draw greater value from pooled revenue than it contributes. Manufacturing skim subsidizes Class I skim, inducing manufacturing skim to depool.

i. Outdated skim component factors contributed an average of -$0.14/cwt. to PPDs during 2020.

j. Updating skim protein to 3.40% would have added an average of $0.38/cwt. to PPDs from 2015 through 2020.

k. Updating the standard skim component factors will bring Class I skim value into closer alignment with manufacturing skim value thereby reducing the incentive for manufacturing milk to depool and the accompanying negative consequences.

6. Impact on Risk Management Strategies
    a. Risk management programs are increasingly more important to producers, processors, and product buyers.
    b. Changes to price formulas will impact prices utilized in risk management.
    c. CME Group futures contracts traded up to 24 months in the future.
    d. Most widely utilized dairy contract is the Class III Milk Futures.
    e. Outstanding contracts are called open interest.
    f. August 11, 2023, total Class III open interest was 21,029.
    g. Open interest as far in the future as March 2025.
    h. 80% of open interest existed in contracts expiring in the next five months.
    i. 93% of open interest existed in contracts expiring in the next 10 months.
    j. Annual skim components will be known by mid-January each year upon completion of Statistical Uniform Prices for December.
    k. Applied to milk marketed the following January provides an 11-month lead time for Class I if advanced pricing is retained, and 12-month lead time if announced pricing is used.
    l. However, NAJ accepts the hearing record may establish that a longer lead time is warranted.
    m. In addition, FMMO skim component trends can be tracked monthly by interested parties.
    n. NAJ Exhibit 5 shows monthly skim components from January 2019 through December 2022.
    o. Average skim components for the first six months each year predicted annual skim components within 0.01% each year effective adding an additional six months lead time between announcement and enactment.
7. Comparison of Class I Skim Values by Order – NAJ Exhibit 6

a. 2019 through 2022 compares each orders' Class I skim components to:
    i. National average skim components pooled that year.
    ii. Skim component factors based on annual updates.
    iii. Skim component factors based on three-year averages updated every three years.
b. Annual updates result in skim component factors being more closely aligned with pooled components than using three-year averages updated every three years.
c. From 2019 through 2022 using annually updated skim component factors only three orders (Northeast, Appalachian, and Florida) had Class I skim component values greater than the value of the actual skim components present in Class I skim of those orders.

8. Closing comments
    a. The objective of the proposals considered at this hearing should be to make the price formulas more accurate.
    b. The current skim component factors of 3.10% protein, 5.90% other solids, and 9.00% nonfat solids do not accurately reflect the skim components in producer milk.
    c. The skim component factors should be updated, and going forward the updates should be done annually to provide the greatest degree of accuracy.
9. Thank you for the opportunity to present NAJ's proposal and supporting data.