

Rebuttal Testimony – Proposal Number 21

Testimony Presented By:

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My name is Carl Rasch and I am here today to present testimony in opposition to Proposal #21 on behalf of the National Milk Producers Federation (NMPF) with the support of the Michigan Milk Producers Association (MMPA). MMPA is a member of NMPF.

I am a private consultant engaged by MMPA to represent their interests at this proceeding. I was also designated to be MMPA's representative on the NMPF task force which developed the recommendations for Federal Order modernization. Those recommendations were ultimately approved by the NMPF board of directors and were included in the notice of hearing issued by USDA.

From 1977 to 2017, I was the director of bulk milk marketing for MMPA. In that capacity, I was responsible for negotiating and executing third party raw milk sales agreements. Additionally, I was responsible for producer payrolls, Federal Order reporting and pooling, and representing MMPA at various public hearings.

The NMPF Federal Order Task Force reviewed many of the current Federal Order regulations during the process of identifying critical issues to be addressed in this modernization process. One of the issues considered by a working group of the task force was the appropriate level of the Class 2 differential. While there was acknowledgement that the differential could be changed, there was no consensus as to how much of a change should be proposed. Therefore, NMPF decided it would not submit a proposal to change the current Class 2 differential of \$.70 per hundredweight which is applicable in all Federal Milk Marketing Orders. It may be appropriate to consider changing the Class 2 differential at a separate Federal Order hearing.

Substitution Incentive

Numerous concerns were expressed in arriving at this decision by the task force workgroup. Chief among them was the possible creation of an incentive to substitute Class 4 powder for fresh milk ingredients which currently are classified as class 2. This would reduce pool revenues which determine the prices received by dairy farmers. Encouraging substitution of lower cost ingredients for higher value fresh milk ingredients is counter-productive to the basic purpose of the Federal Order program.

NMPF is concerned that the Class 2 differential proposed by the American Farm Bureau Federation (AFBF) would create an incentive to substitute milk powder for fresh milk. AFBF's method to determine the proposed differential of \$1.56 per hundredweight is too simplistic. Because milk powder is relatively non-perishable, it can be purchased today at an attractive price, stored under proper conditions, and utilized within twelve months when it more financially advantageous. In other words, the original cost of the ingredient may be less than the current cost of that same ingredient. Setting the Class 2 differential too high may incentivize the practice of substituting cheaper powdered milk for fresh milk.

The cost of transportation of ingredients is another concern not addressed by the AFBF proposal. Milk powder is a concentrated form of milk solids. Far more so than raw milk or concentrated skim milk. The buyer of milk solids is typically located some distance from the source of the product and transportation costs are incurred in delivering the product to its destination. Because milk powder has nearly all the cow water removed, it is much cheaper per pound of milk solids to transport than fresh milk ingredients. AFBF's rationale for establishing a new and higher differential value does not account for this added cost for fresh milk ingredients. This difference in transportation cost also contributes to the incentive to substitute milk powder for fresh milk ingredients.

Disorderly Marketing

Federal Order regulations do not require the pooling of revenue generated by Class 2 usage unless the handler is a fully regulated distributing plant. Consequently, if a class price misalignment exists, there is an opportunity to de-pool significant volumes of class 2 milk. In fact, the current differential of \$.70 per hundredweight has consistently provided an incentive to de-pool Class 2 milk. Because I am most familiar with marketing activities within the Mideast milk marketing order, I will use statistics for that market for illustration purposes.

Beginning in December of 2021, there have been incentives to not pool Class 2 milk on the FO #33 every month. Due to the strength of non-fat milk powder and butter prices relative to cheese and whey prices, there has been a significant price spread between Class 4 and Class 3 prices for the last 23 months. After adding the \$.70 per hundredweight differential to the Class 4 advance price factor, Class 2 skim prices averaged \$14.32 per hundredweight vs. a \$10.92 per hundredweight Class 3 average for calendar year 2022. The Class 2 skim value exceeded the Class 3 skim by \$3.40 per hundredweight. Additionally, the Class 2 butterfat value exceeded the Class 3 butterfat price by \$.007 per pound. The average P-P-D for Federal Order #33 during 2022 was \$1.50 per hundredweight. The Class 2 price exceeded the sum of the Class 3 price plus the P-P-D every month which would have resulted in a payment obligation to the producer settlement fund if the Class 2 milk were to be pooled.

The same milk price misalignment continues to exist in 2023. Through the month of October, the average Class 2 price was \$10.15 per hundredweight and the Class 3 price was \$7.17 per hundredweight, which is a difference of \$2.98 per hundredweight. The average P-P-D through October was \$1.58 per hundredweight. Class 2 milk pooled on Federal Order #33 also would have had a payment obligation to the producer settlement fund for every month of 2023. Consequently, there has been a huge decline in the volume of Class 2 milk participating in the Federal Order #33 pool beginning in December of 2021.

The annual volumes of Class 2 milk pooled on Federal Order #33 have been:

2020	4,065,109,000 pounds
2021	3,857,237,000 pounds
2022	1,517,464,000 pounds
2023 (10 mos.)	1,200,786,000 pounds

Not only does this create inequity for dairy farmers due to non-uniform prices paid in a common market, it also results in unequal procurement costs for suppliers. An entity that supplies milk to a fully regulated plant for Class 2 usage is paid the market's uniform price while another entity that supplies milk to an unregulated plant for Class 2 usage is typically paid the prevailing Class 2 price. As demonstrated earlier in my testimony, the difference between the Class 2 price and the market uniform price has been huge during 2022 and 2023. For 2022, the difference on average was \$1.91 per hundredweight and so far in 2023 the difference on average has been \$1.40 per hundredweight.

Many pool distributing plants generate excess cream which is not utilized in the production of packaged Class 1 products. Traditionally, this excess cream has been utilized to produce butterfat intensive byproducts such as half & half, whipping cream, sour cream, cottage cheese, and ice cream mixes. All these products are categorized as Class 2 and any distributing plant that is fully regulated has this Class 2 utilization included in the calculation of the plant's total classified value and its obligation to the producer settlement pool. However, if these same byproducts were to be produced at a partially regulated or completely unregulated plant, those plants would have no obligation to the pool if they chose to not pool the milk. This creates a huge cost disadvantage for a pool distributing plant. As an operator of a pool distributing plant at Canton, Ohio this price disparity causes MMPA great concern. If the Class 2 differential was to be increased to \$1.56 per hundredweight as proposed by AFBF, we envision almost all Class 2 production being shifted to non-pool facilities and the elimination of a valuable source of revenue from the Federal Order #33 pool.

Conclusion

NMPF opposes the adoption of Proposal 21 for all the reasons presented in my testimony. Also, NMPF believes that AFBF's proposal to increase the Class 2 differential is a subject better

addressed at a future Federal Order hearing. NMPF has offered 5 proposals which are intended to modernize Federal Order regulations. All of these will affect the calculation of class prices. Not knowing what the outcome of this public hearing might be, it is impossible to evaluate the consequences of any change to the Class 2 differential at this time. Additionally, there are issues separate from the correct value for the differential that need to be considered that are not addressed in Proposal 21. Therefore, USDA should reject Proposal 21 and maintain the Class 2 differential at \$.70 per hundredweight.

Respectfully submitted,

Carl Rasch
On behalf of NMPF