



National Milk Producers Federation

Impact of Federal Order Reform on the Southeast Dairy Industry

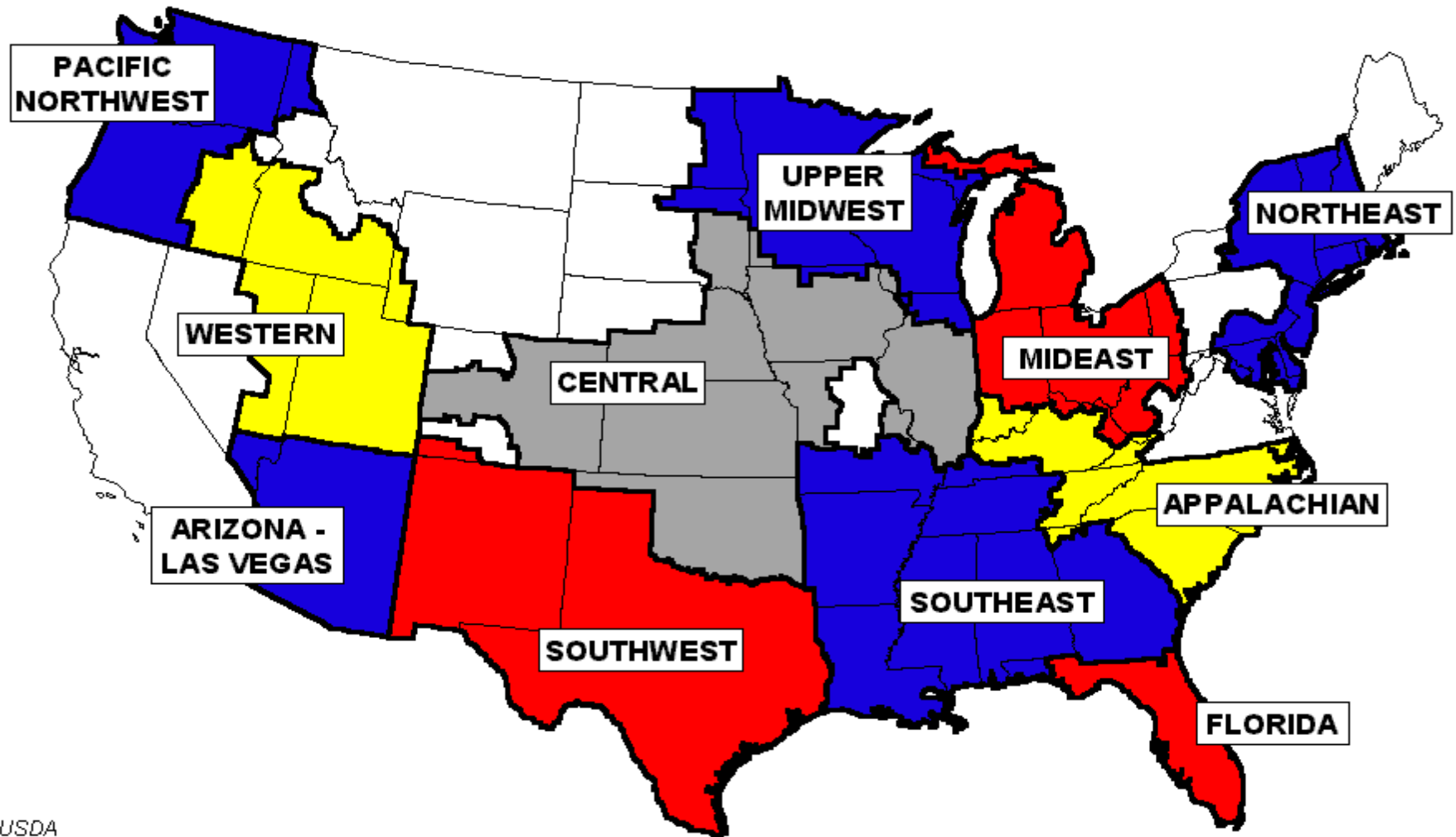
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What's In FMMO Reform?

- Consolidation of Federal Orders
- Multiple Component Pricing
- New Class I Mover
- Option 1A Class I Differentials
- New Price Announcement Dates
- Forward Contracting Pilot Program

FEDERAL MILK MARKETING ORDER AREAS

January 1, 2000



USDA
Agricultural Marketing Service
Dairy Programs

DIFFERENCES IN SHADING MERELY SERVE TO DIFFERENTIATE BETWEEN MARKETING AREAS

Multiple Component Pricing

- Four Classes of Milk
 - Classes I and II are basically the same; Class III is for cheese and the new Class IV is for Butter/Powder.
- Price of milk in all classes will be determined using the value of milk components (butter, protein, nonfat solids, and other solids).
- Butterfat differential is discontinued.
- Data from the NASS Survey of Commodity Prices will be used to determine 2-week and monthly average prices for butter, cheese, NFDM, and whey.

Class I & II Issues

- Class I mover is the higher of Class III or IV; not just Class III like the old system. Should help reduce class price inversion and depooling.
- Forward pricing for Class I and II is reduced to about two weeks instead of one month.
- Class I Butterfat is also priced in advance; in the old system Class I handlers did not know BF Differential until the month after the sale.
- Class II Differential is increased from \$0.30 to \$0.70 per hundredweight.

Class I & II Issues (Continued...)

- Option 1A Differentials with each county assigned a Class I Differential.

	Current	Final Rule	Option 1A
	Dollars Per Hundredweight		
Carolina	3.08	2.55	3.10
Tennessee Valley	2.77	2.25	2.80
Loui-Lex-Evans	2.11	1.95	2.20
Southeast	3.08	2.90	3.10
Upper Florida	3.58	3.80	3.70
Tampa Bay	3.88	4.20	4.00
Southeastern FL	4.18	4.75	4.30
Market Average	2.58	2.28	2.60

Important Price Release Dates

Advanced Price Announcements for Class I & II (Skim)

Prices for
this Month

Are Released
on this Date

January	Dec 23
February	Jan 21 10:30AM
March	Feb 18 “
April	Mar 17 “
May	Apr 21 “
June	May 19 “
July	Jun 23 “
August	Jul 21 “
September	Aug 18 “
October	Sep 22 “
November	Oct 20 “
December	Nov 17 “

What will be announced?

Class I Mover

Class I Price

Class I Skim Milk Price

Class I Butterfat Price

Class II Skim Milk Price

Class II NF Solids Price

Price Release (continued....)

Other Class and Component Price Announcements

Prices for
this Month

Are Released
on this Date

January	Feb 4	10:30AM
February	Mar 3	“
March	Mar 31	“
April	May 5	“
May	Jun 2	“
June	Jun 30	“
July	Aug 4	“
August	Sep 1	“
September	Sep 29	“
October	Nov 3	“
November	Dec 1	“
December	Jan 5	“

What will be announced?

Class II Butterfat Price

Class II, III, & IV Price

Class III & IV Skim Price

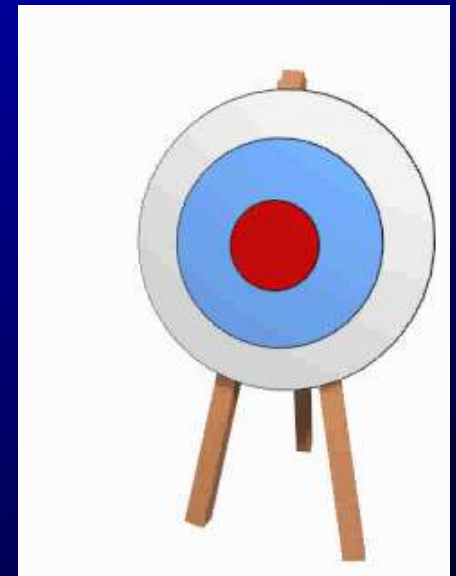
Prices for Butterfat,
Nonfat Solids, Protein,
and Other Solids

Somatic Cell Adjustment

Comparison of Class I Price Mover

	1999 Class I Mover (\$ per cwt)		
	Pre-Reform	Reform	Difference
Jan	16.84	17.44	+0.60
Feb	17.34	16.90	-0.44
Mar	16.27	12.74	-3.53
Apr	10.27	12.75	+2.48
May	11.62	11.67	+0.05
Jun	11.81	11.16	-0.65
Jul	11.26	13.04	+1.78
Aug	11.42	12.88	+1.46
Sep	13.59	15.26	+1.67
Oct	15.79	16.54	+0.75
Nov	16.26	12.90	-3.36
Dec	11.49	11.59	+0.10
Avg.	13.66	13.74	+0.08

Data published in the Final Rule for informational purposes only indicated a \$0.20 difference from 1994-1998.



Comparison of Class II

1999 Class II (\$ per cwt)

	Pre-Reform	Reform	Difference
Jan	17.14	14.31	-2.83
Feb	17.64	13.72	-3.92
Mar	16.57	13.47	-3.10
Apr	10.57	12.05	+1.48
May	11.92	12.21	+0.29
Jun	12.11	13.84	+1.73
Jul	11.56	13.50	+1.94
Aug	11.72	13.46	+1.74
Sep	13.89	13.29	-0.60
Oct	16.09	12.50	-3.59
Nov	16.56	12.26	-4.30
Dec	11.79	11.64	-0.15
Avg.	13.96	13.02	-0.94

Data published in the Final Rule for informational purposes only indicated a \$0.01 difference from 1994-1998.

Comparison of Other Prices

	1999 Average (\$ Per Cwt.)		
	Pre-Reform	Reform	Difference
Class III	\$12.43	\$12.45	\$0.02
Class IV	\$12.14	\$12.26	\$0.12
Butterfat (\$ per pound)	\$1.3098	\$1.3602	\$0.0504

Data published in the Final Rule for informational purposes only indicated a \$(0.47) difference for Class III and \$(0.04) difference for Class IV from 1994-1998.

Where do we go from here?

National Dairy Hearings on Class III & IV

- * Proposals are due February 29th.
- * Hearing will take place late April or early May.
- * Because of the election year, expect findings to be announced late November with the final decision to be published in the Federal Register on December 1.
- * Implementation of the final decision will be January 1, 2001.
- ** The results of this hearing will impact all market prices, not just Class III & IV.

What's up with Butterfat?

How will the Price of Butterfat Change?

- No longer will announce a butterfat differential.
- Butterfat Formula: **(NASS AA Butter Price -0.114) / 0.82**;
 - Notice that \$0.09 is not subtracted to get Grade A equivalent.
- There will be three different butterfat price announcements:
 - Class I: announced on or before 23rd of each month, advanced butterfat price plus CI differential / 100;
 - Class III/IV: announced on or before 5th of each month;
 - Class II: announced on or before 5th of each month; butterfat price plus \$.70 / 100.

Comparison of 1999 Butterfat Values

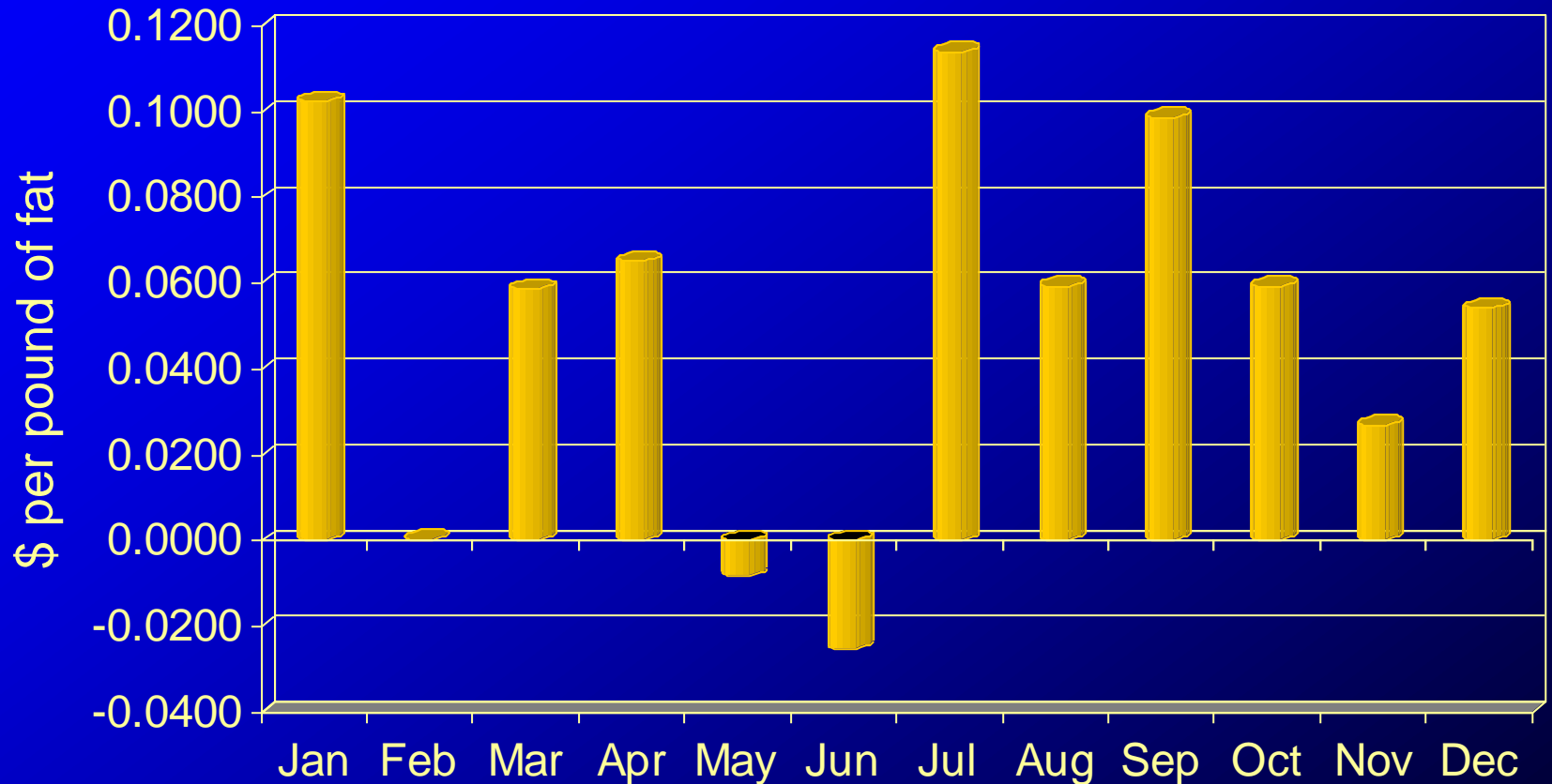
(\$ per lb of fat)

	Pre-Reform	Reform	Difference
Jan	1.4848	1.5871	0.1024
Feb	1.4441	1.4444	0.0003
Mar	1.3900	1.4486	0.0586
Apr	1.0349	1.1000	0.0651
May	1.1838	1.1757	-0.0081
Jun	1.6679	1.6426	-0.0253
Jul	1.4290	1.5430	0.1140
Aug	1.4703	1.5296	0.0593
Sep	1.3785	1.4771	0.0986
Oct	1.1764	1.2357	0.0593
Nov	1.1314	1.1582	0.0268
Dec	0.9262	0.9804	0.0542
Avg.	1.3098	1.3602	0.0504

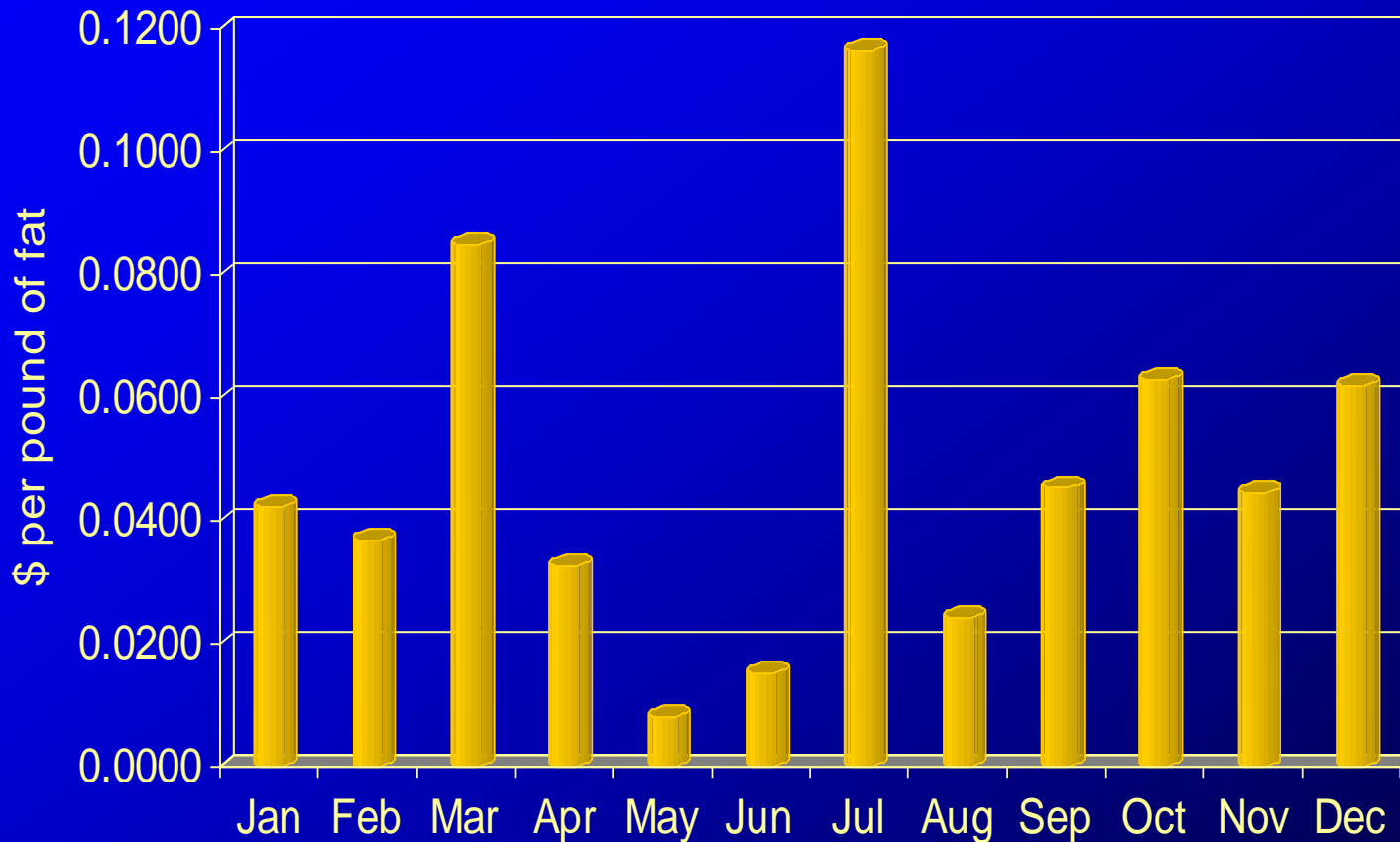
- For 1999, butterfat prices with the new FMMO formulas would have averaged about \$0.05 higher.

- Why a higher fat price? Nine cents is no longer subtracted from the Grade AA Price.

Comparison of 1999 Butterfat Prices (Reform - Pre-Reform)



How do Reform Class III/IV Butterfat Prices Compare with California (1999 Avg, Reform - CA)



For 1999,
Reform
Price
averaged
\$0.048
higher than
California.

Why will the California Fat Price be Lower ?

- The differences are in the Formula:

	FMMO	California	Result
Reference Price	NASS AA	CME AA	+0.0074
Make Allowance	0.114	0.097	+0.0204
Yield Factor	4.2686	4.2000	-0.0218
Transportation Adjustment	0.000	0.045	-0.0540

FMMO Formula: (NASS AA Price -0.114) / 0.82;

CA 4a-b Formula: (CME AA Price -0.097 - 0.045) * 1.2;

FMMO Reform and the need for Risk Management

Impact of FMMO Reform on Risk Management Opportunities for Class I & II

Opportunities are extremely limited!

- Class I Mover increases risk
 - With the higher of Class III or IV, you cannot be certain which market will drive Class I in the future.
 - Advanced Class III or IV also creates uncertainty.
- For Class II, solids are priced in advance and butterfat price is announced in the month after the sale.
- There is no Class IV futures contract. Trying to use Class III will increase basis risk.
- Forward contracting with your cooperative does not eliminate these problems.

Forward Pricing Pilot Program

- With FMMO Reform, authority for a pilot program was granted for all Classes of milk except Class I.
- Program implementation no later than early March.
- Prices paid under this program satisfy all minimum federal order price requirements.
- Authority for this program terminates on 12/31/2004.
- USDA will study and evaluate the impact of the pilot program on producer prices. This report will be available on 4/30/2002.

Concluding Remarks

- Overall, Final Rule appears to be a good reform package.
- Strength: producer price signals are related to components and more closely tied to current market conditions.
- Weakness: formula and survey basis may result in frequent updates.