

# Milk Producers Council

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PAGES: 4

TO: DIRECTORS & MEMBERS

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## MPC FRIDAY MARKET UPDATE

### CHICAGO MERCANTILE EXCHANGE

Blocks    -\$ .0325    \$1.2700  
Barrels   -\$ .0475    \$1.3075

### CHICAGO AA BUTTER

Weekly Change   -\$ .0300    \$1.1400  
Weekly Average   -\$ .0493    \$1.1467

### NON-FAT DRY MILK

**Week Ending 12/19 & 12/20**

Calif. Plants    \$.8336    18,708,787  
NASS Plants       N/A           N/A

### Weekly Average

Blocks   -\$ .1192    \$1.2808  
Barrels   -\$ .1253    \$1.3342

### DRY WHEY

**WEST MSTLY AVG**   w/e 12/24/08    \$.1525  
**NASS**               w/e 12/24/08    N/A

**CHEESE MARKET COMMENTS:** Blocks lost another 3+ cents this week on the CME, and have now decreased eleven straight trading days, as reports of higher production, higher inventories, and disappointing outlooks dampen spirits and place buyers in a strong position. Dairy Market News reports that January may show more buyer interest, but the CME futures market doesn't lend much support for that interest to lead to higher cheese prices. **Class III prices for every month in 2009 are projected to be lower than December 2008's price**, starting with a drop of \$3.41 per cwt in January. The strong cycle for weekly cheese prices on the CME that began in May 2007, which saw prices range between \$1.70 and \$2.00+, was broken this month. The combination of just a little more production than last year which began this June, growing inventories, less interest from exporters, and the understandable loss of consumer confidence knocked away the last pillar of support for good milk prices. The last price peak in the recent cycle occurred on November 25<sup>th</sup>: \$1.8025 for blocks. The \$.5325 price difference from then to now is **equivalent to \$5.40 per cwt of milk in just 30 days**. That's a violent assault on dairymen's future income.

**BUTTER MARKET COMMENTS:** Butter prices lost half of what they gained last week, and the weekly average is now about where it was during so many weeks in 2006. Other than the last several reports of lower month-end inventory levels, there simply is nothing to suggest that butter prices may increase anytime soon. A lot of butter is going to be produced this week and next, and sales forecasts have not been good. That probably means butter prices could stay low for some time. The CME futures prices through the month of April are below \$1.20 per lb. Fewer cows, less milk, lower butter production, and the current very low prices combine to establish a good foundation for future price increases, but something more – a stimulus of some kind – may be needed to make it happen.

**POWDER MARKET COMMENTS:** More sales to the government, lower export volumes, growing inventories, and cautious buyers means continuing very low prices for nonfat dry milk. DMN says the high end of the Western "mostly" price range last week was \$.83 per lb, and the highest price they could find for a truckload of product was \$.87 per lb. There is now more than 100 million lbs of nfdm being stored by USDA in California, which can be sold for \$.88 per lb. As that volume grows, it tends to set a firm cap on prices for commercial sales.

**WHEY MARKET COMMENTS:** The reports on Whey Protein Concentrate prices remain positive; DMN finds that buyers may have become believers that the price bottom for WPC was reached a few weeks ago, and now is the time to become serious about locking in future commitments for volumes and, they hope, prices. Demand and prices for Dry Whey continue to be weak. The average of the Western "mostly" prices this week edged down by a quarter cent, well below the cost of producing the product, which has been the case now for just about two months.

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## FRED DOUMA'S PRICE PROJECTIONS...

Dec 26 Final:      Quota cwt. \$14.36    Overbase cwt. \$12.66    Cls. 4a cwt. \$10.31    Cls. 4b cwt. \$13.95  
Last week:        Quota cwt. \$14.39    Overbase cwt. \$12.69    Cls. 4a cwt. \$10.35    Cls. 4b cwt. \$13.98

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## **MORE THOUGHTS ON A POSSIBLE CALIFORNIA FEDERAL ORDER:** *(By Geoffrey VandenHeuvel)*

In the past few issues of this newsletter, we have laid out some of the arguments for why California should seriously consider developing a California Federal Milk Marketing Order (FMMO). As we've explained, it is truly the **ONLY** way we can recapture the class 1 revenue we are currently losing to out-of-state milk. CDFA recently reduced our class 1 price by \$0.35 per cwt in an apparent attempt to slow down that milk coming from out-of-state. But will that price reduction slow down that milk and bring any additional class 1 processing capacity back to the pool? Absolutely not. The only thing that hearing decision accomplished was taking almost **\$2 million a month from producers**, gift wrapping it, and giving it to the class 1 processors in the state. **It bought us absolutely no additional processing capacity. How much further are producers willing to slash our milk price in an effort to cling to what's left of our class 1 market?**

Despite the undeniable arguments in favor of developing a California FMMO for the industry to consider, there are some in the industry that have doubts. A number of questions have been raised regarding a possible California FMMO, and I'd like to respond to a few of those today.

**(By the way, if you have any questions about the potential of a California FMMO, we want to hear from you. Please email us at [fmno@milkproducers.org](mailto:fmno@milkproducers.org). Our industry needs a healthy discussion on this issue, and feedback from our readership would be extremely valuable.)**

### ***“How would quota be handled? Would Congress allow the quota system to be part of a California FMMO?”***

This would have to be answered in the development of a transition plan from the current state order to a new California FMMO. The 1996 Farm Bill included provisions that would have allowed California to become a FMMO and keep our quota system in tact. That “offer” by Congress has expired, but that does not mean that Congress would not be willing to pass a similar provision again.

An analysis might reveal that it would be better to eliminate the quota system in a California FMMO. In that case quota holders would need to be compensated for their quota. This could be done by reserving a portion of the pool proceeds over some period of time to pay for a quota retirement program. This too would need Congressional action.

A more fundamental question is how can quota survive in the California state order if most of the pool proceeds from class 1, 2 and 3 are lost because of reduced classified prices? The system will not survive long if month after month the overbase price is less than the combined pool income from class 4a and 4b.

### ***“What about the “de-pooling” that plants do in Federal Order areas? The California state order has strict rules about plants that choose to de-pool. If more plants are able to de-pool in a FMMO, wouldn't that hurt the producers who are left in the pool?”***

When we talk about the issue of de-pooling, let's remember that the California state order is completely incapable of protecting the integrity of the California class 1 market. A substantial portion of California's class 1 market is essentially being “de-pooled” by the importation of out-of-state raw and packaged milk.

As for the de-pooling of class 4a and 4b milk, each FMMO can have its own rules on pooling requirements. A California FMMO could have a much stricter pooling requirement than other FMMO's. There is no reason this issue could not be addressed up-front in the development of a California FMMO.

### ***“The F.O.B. California adjuster that California plants receive is a major factor in allowing California***

***manufactured products to move east. Surrounding federal orders having great difficulty competing with Eastern plants because there is no regional adjustment. Wouldn't this potentially hurt our ability of our plants to compete with plants in the Eastern U.S.?"***

The California FOB Adjuster is simply a fancy name for a discount that CDFA has given California plants. When the FOB adjuster was adopted, many years ago, the federal order class III and IV formulas were dominated by Midwestern manufacturers. In the last 10 years the center of the manufactured dairy product world has moved to the West and NASS prices that drive the FMMO formulas are by-in-large Western (California) cheese, butter and powder prices. With the changes made to FMMO formulas recently, there is very little spread between the FMMO Class III and IV prices and the comparable California Class 4a and 4b prices. I don't think California producers are all that excited about further discounting our class 4a and 4b prices for any reason.

***"California limits the growth of Producer-Distributors. If these limits were lifted in a FMMO, then couldn't new or existing P-D's could capture more of our class 1 revenue?"***

Both the Pacific Northwest and the Arizona FMMO's have strict limits on the size of Producer-Distributors. A California FMMO could have those same restrictions. Furthermore, of the 5 remaining P-D's in California only one would qualify as a P-D under the standard Federal Order rules and maybe not even that one.

***"What about California's fluid milk standards? They are higher than the standards in FMMOs. And what about the fortification allowance we give to our class 1 processors? How does a FMMO address that? Without the fortification of our fluid milk, there could be another 70 million pounds of powder on the market."***

The United States Congress specifically and permanently authorized California to establish and maintain higher fluid milk standards. This has been upheld in Federal court. There is no reason to drop our fluid milk standards simply because we have a FMMO.

There are no fortification allowances in any other FMMO. Looking at what retail prices are for low fat/high solids milk does raise the question about why producers should be required to subsidize what in the marketplace is a premium product.

***"The California state order allows us to undercut the rest of the country and provides a competitive advantage for the processors in our state. Wouldn't we lose this if we moved into a FMMO?"***

What competitive advantage? And where are the additional plants? Golden Cheese in Corona, California shut down and new cheese plants have been built in the last couple of years in New Mexico, Texas, and Iowa, all of which are Federal Order areas. The McKinsey Group study pointed out that California could no longer create a competitive advantage simply by discounting our milk price.

***"If we moved into a FMMO, we would lose the control we currently have over our system. Changes to the milk pricing formulas can be made in a matter of months in CA, whereas it takes possibly years to make changes in FMMOs."***

Rapid change in milk pricing regulation is destabilizing. No one has any confidence that the rules won't change in the middle of the game. As a practical matter, change comes much slower in the FMMO system, and what change does happen requires a positive producer vote to be implemented. This fact tempers USDA in their decision-making process. In addition, the recently enacted farm bill does require USDA to tighten up the hearing process.

A more relevant question to ask yourself is how many of California's rapid hearing decisions over the past decade have been to producers liking? Precious few.

*“Developing a California FMMO seems drastic. Couldn’t we take some other action that would provide relief to producers without sacrificing our state order? Such as:*

- *Continuing the base programs to help lessen plant capacity concerns?*
- *Gaining control of our distressed milk so that it is not available for out-of-state processors (such as the Yerington plant in Nevada)?”*

The base plans in California are not state implemented, they are privately (cooperative) implemented. Whether we are a state order or a federal order should have no bearing on this issue.

As for the Yerington plant, even if California were to completely eliminate distressed milk, there would still be low-cost milk available to that plant from Utah, Idaho, and Montana. And the Northern Nevada regulated price has been established at the Northern California class 1 price less \$1. Without the power of a federal order, cheap Yerington packaged milk will continue to flow into California.

**The bottom line is that every question and objection that we’ve come across so far has an answer.** The problem of out-of-area milk undermining a local class 1 market is not a new problem. Decades ago there were many state milk marketing orders in the Eastern part of the U.S. just like California’s. These state orders were not able to regulate out-of-state milk any better than California is now. Congress provided a solution to this problem by establishing the Federal Milk Marketing Order (FMMO) program. FMMOs have the authority to regulate both raw and packaged milk class 1 milk – **an authority that state orders simply don’t have.** FMMOs are designed to protect the local class 1 market from out-of-order milk. They do this by assessing out-of-order handlers a “compensatory payment,” which goes to local producers, eliminating the economic incentives that drive the interstate movement of milk.

**The California state order has served producers well for many decades, but it is no longer capable of addressing the problems we face.** California producers are giving up millions of dollars in monthly income because of the state’s inability to regulate interstate commerce. We owe it to ourselves to make a serious attempt to determine whether we can make a FMMO work in California.

This cannot happen without the support of our cooperatives. In any FMMO, the co-ops block vote for their members, so any serious attempt to even examine a California FMMO can be blocked if one of the major co-ops is opposed to it. Please pick up the telephone and call your board members! **Ask your boards to support the development of a California FMMO.** This doesn’t mean they will have to ultimately support it – just that we should take a look at what it could do for producers in California. **Your co-op board must hear from you!**

**(As I said before, if any of you has questions beyond the topics discussed above, we want to hear from you! You can email us at [fmomo@milkproducers.org](mailto:fmomo@milkproducers.org) or you can call the office at 909-628-6018.)**

*End*