



Latest answers leave lingering questions

USDA says dairy farmers lost \$50 million over 14 months based on 51 weeks of misreported nonfat dry milk sales

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Reprinted from Farmshine – June 4, 2007

BROWNSTOWN, Pa. – The USDA powdered milk price mix-up, cost dairy farmers \$50 million or 4-cents per hundredweight across federally regulated milk markets over the past 14 months (April 2006 through May 2007). This, according to two USDA announcements last Thursday, June 28.

First, the National Agricultural Statistics Service (NASS) released a special report with revisions to nonfat dry milk prices, based on new data from five firms over a 51-week period: April 29, 2006 through April 14, 2007.

On the same day, USDA's Agricultural Marketing Service (AMS) announced the impact – the \$50 million price tag paid by dairy farmers – which fell well short of the damage estimates that have been circulating within the industry for weeks.

The USDA announcements concluded that since “the federal order pools for the 14-month period have been settled, and all revenues have already been distributed...

there are no federal order provisions that could generate additional revenues for these settled pools to make up the pricing differences....”

The news came 10 weeks after USDA first confirmed that dairy farmers were shortchanged during the last three weeks in March, when nonfat dry milk prices were misreported due to one plant’s inclusion of forward-priced sales in the weekly NASS survey reporting. Sales priced 30 days or more ahead of the completed transaction, are to be excluded from reported sales.

A numbers game

Judging by the wide difference – between NASS survey prices in relation to spot sales reported weekly by AMS Dairy Market News and also the international skim milk powder prices – the USDA investigation was expected, by many, to reveal a more substantial impact on dairymen’s paychecks during fourth quarter 2006 through first quarter 2007.

Considering the NASS average correction of 1.7 cents per pound for the 51 weeks, an impact of 4-cents/cwt. on classified milk values, seems low. Industry analysts have indicated for months that a penny per pound in the nonfat dry milk price translates to about 9-cents per hundredweight in the dairyman’s milk price. Stands to reason that 1.7-cents per pound in the nonfat dry milk price could be worth more like 15-cents/cwt. to dairy farmers over the past 14 months.

In the AMS impact report, product volumes for the Class II and IV pricing factors, were reduced substantially. These volume revisions and the potential reallocation effects: beg more questions.

AMS notes: “it is possible that some milk would have been reallocated among classes in the federal order system had the NASS revisions been in effect when federal order prices were announced. Reallocation effects have not been considered for this analysis.”

Questions are fueled by the fact that mandatory reporting has not yet been implemented, even though Congress twice authorized it: once in 2000 and again in the 2002 Farm Bill. At the same time, there is no process in place for verifying the accuracy of the sales data supplied by dairy product manufacturing plants to the NASS survey.

A matter of timing?

The weightiest portion of the NASS reporting errors began in the fourth quarter of 2006. The timing is interesting because NASS reportedly issued “guideline reminders” to all dairy product manufacturing plants in October 2006.

At the same time, the international skim milk powder market gained momentum and spot sales reported by Dairy Market News were advancing sharply. The period of largest negative reporting errors continued as the global powder market charted an unprecedented rise into the spring of 2007. This fact alone, breeds suspicion as today’s market environment for nonfat dry milk is big business. This product is no longer the everlasting government warehouse staple of yesteryear.

Role of forward-priced sales

According to the NASS Dairy Product Prices Survey, all sales are to be reported except sales of: 1) product that is more than 180 days old; 2) nonfat dry milk produced using a high heat process; 3) instant nonfat dry milk; 4) dry buttermilk; 5) nonfat dry milk within the same company; 6) nonfat dry milk that has already been purchased and is being resold; 7) forward-priced nonfat dry milk.

The last item on the list is prone to misinterpretation and perhaps manipulation, because NASS qualifies the forward-priced exception as “not including sales through the Dairy Export Incentive Program (DEIP).” In recent years, less and less exported dairy product sales occur through DEIP. A company may export some product through DEIP and some without DEIP.

Dairy farmers depend on accurate NASS survey data, because the data are used to set milk class minimum prices in the federal order system. The nonfat dry milk reporting errors, highlight the importance of mandatory reporting and independent verification.

Coincidentally last Thursday – on the same day the NASS revisions and AMS impact statements were released – AMS also issued an interim final rule, to finally establish a “Dairy Product Mandatory Reporting Program as required by law.” (See related story in this issue of *Farmshine*.) The mandatory reporting program will be implemented on August 2, 2007.

How nonfat dry milk is bought, sold, and exported leads to additional questions. Producers in California are aware of the forward-pricing issues because these sales are still included in the price formulas for California’s state-regulated milk market. According to the website of California Dairy Campaign (CDC) – a nonprofit membership association of family dairy farms in California – producer groups recently petitioned state milk marketing authorities to exclude forward-priced contracts from the pricing picture because, they say, “nonfat dry milk sales are heavily weighted by DairyAmerica’s sales to Fonterra (a major international firm), for subsequent sales to foreign buyers.”

CDC also points out that “the present prices charged by DairyAmerica to Fonterra for nonfat dry milk are estimated to be about 60 cents per pound below the prevailing international prices... and additional long-term contracts are currently being negotiated.”

DairyAmerica, Inc., is a federated marketing company, an association of nine producer-owned dairy cooperatives, according to its website. Based in California, the nine dairy cooperatives it represents in sales of nonfat dry milk and other dry dairy products, are California Dairies, Inc., Land O’ Lakes, Maryland-Virginia, DFA, Agri-Mark, Lone-Star Milk Producers, United Dairymen of Arizona, O-AT-KA, and St. Albans Cooperative.

The reporting, revision and verification process

The NASS special report was the result of the agency re-clarifying the sales reporting guidelines to all plants, and then asking the 39 plants, nationwide, to verify their sales and revise their weekly data if necessary.

During this “self-verification” process, revisions were reported to NASS by five firms, including the withdrawal of sales totaling 214 million pounds from the 51 weeks of

revised data. That's 25% of the originally reported sales volume of approximately 890 million pounds for the period.

How did the firms interpret the clarified NASS-survey guidelines? Were spot sales in which transactions were not completed within 30 days due to external factors excluded, or included? Were the export sales properly included or excluded? The bottom line here is this: who is really selling what, for whom and to whom... and at what price?

Who really knows? There is no independent verification process. That will reportedly change in August when mandatory reporting is implemented.

Plants were reminded of guidelines in October

It is curious that NASS had already re-clarified the guidelines in a "reminder" issued to plants in October 2006, and yet the situation got worse after the reminder. In its April announcement of misreported prices, **NASS stated that the proper reporting guidelines "were reiterated to all participating plants in October 2006 and at that time all nonfat dry milk plants indicated they were in compliance with these guidelines."**

So how is it then, that the most severe under-statement of the nonfat dry milk price occurred in the 18 weeks FOLLOWING that October 2006 "guideline reminder"?

During those 18 weeks following the reminder (November 11, 2006 through March 10, 2007) the nonfat dry milk price was under-stated by an average of 4.2 cents per pound. In September, 2006 – one month prior to the NASS guidelines reminder – the nonfat dry milk sales were under-stated by an average of 1.3 cents per pound. For the 18 weeks before the October "guidelines reminder" – excluding the month of September – the nonfat dry milk prices were essentially unrevised because in about half of those weeks, the values were over-stated by less than one cent per pound and in the other half, the sales were under-stated by less than one cent per pound.

Did the "guidelines reminder" in October serve to clarify, or muddy, the waters?

Apparently this market is still quite murky, as the most recent Dairy Market News report last Friday (June 29) reported: "traders characterize the current market as 'sloppy' and 'confusing'." The report also indicates a good bit of resale activity in nonfat dry milk recently.

Details from AMS impact analysis

NASS itemized the 51 weeks of revised nonfat dry milk prices: reporting 14 weeks in which the prices were over-stated by less than one cent per pound and 37 weeks in which the prices were under-stated by 2 cents to 8.5 cents per pound. The combination of lower and higher adjustments, translated to the revised average increase of 1.7 cents per pound for the 51-week period.

In its June 28 impact statement, AMS said the NASS revisions changed the pricing factors for Class II skim milk by an average of 19 cents per hundredweight for the 14-month period across all federally regulated markets; and by 17 cents/cwt. for Class IV skim milk.

The \$50 million loss figure, factors-in the months in which the nonfat dry milk prices were over-stated (mainly April through June 2006) along with the months in which

the nonfat dry milk prices were under-stated (mainly September 2006 through March 2007).

AMS also noted that the revisions affected only the skim milk values of Class II products (i.e. yogurt, ice cream, and cottage cheese) and Class IV products (i.e. butter, nonfat dry milk, and skim milk powders). The department maintains that the value of Class I (bottled milk) and Class III (cheese) milk were not affected by the milk powder price revisions. USDA AMS also maintains that no butterfat values were affected in any of the milk classes by the mistake.

According to the charts accompanying the AMS announcement, the \$50 million loss represents understatements of \$30 million for Class II and \$20 million for Class IV. Combined, this represents a 0.25% loss in the total classified value of milk regulated under the federal order system for the 14-month period. On a per-hundredweight (cwt.) basis: AMS figures the regulated classified milk value was under-stated by an average 4-cents/cwt. across all federally regulated markets for the 14-month period.

The three federal order markets with the greatest understatement of total classified milk value (\$0.04/cwt. x gross receipts) were the Northeast, the Mideast, and the Central markets. The two federal order markets with the greatest understatement in classified value per hundredweight (\$0.06) were the Pacific Northwest and the Arizona markets.

In analyzing the impact of the revisions to the market, AMS took into consideration the total volume of milk regulated and the proportion of milk in the market that is Class II and Class IV.

The per-hundredweight corrections and total classified milk value losses, for each milk marketing order according to AMS, are as follows: **Arizona** - \$0.06/cwt. - \$2.4 million; **Pacific Northwest** - \$0.06/cwt - \$5.4 million; **Northeast** - \$0.04/cwt - \$11.6 million; **Appalachian** - \$0.04/cwt. - \$3 million; **Mideast** - \$0.04/cwt. - \$8 million; **Central** - \$0.04/cwt. - \$6.3 million; **Southwest** - \$0.04/cwt. - \$4.9 million; **Southeast** - \$0.03/cwt.- \$2.7 million; **Florida** - \$0.02/cwt. - \$0.8 million; **Upper Midwest** - \$0.02/cwt. - \$4.7 million.

Using the AMS impact analysis for the Northeast and Mideast Orders (\$0.04/cwt), we estimate that a 100-cow dairy, making 75 pounds of milk per cow per day, lost a total of \$1,278 in income over the past 14 months (or an average of \$91 per month). For a 500-cow dairy making 75 pounds of milk per cow per day this estimated loss would be \$6,390 over the 14-month period (or an average of \$456 per month).

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