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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Parts 1001, 1002, 1004, 1005, 1006, 1007, 1012, 1013, 1030, 1032, 1033, 1036, 1040, 1044, 1046, 1049, 1050, 1064, 1065, 1068, 1076, 1079, 1106, 1124, 1126, 1131, 1134, 1135, 1137, 1138, and 1139

[Docket No. AO–14–A68, et al.; DA–98–01]

Milk in the New England and Other Marketing Areas; Final Decision on Proposed Amendments to Tentative Marketing Agreements and to Orders and Termination of Proceeding

7 CFR Part	Marketing area	AO Nos.
1001	New England	AO–14–A68
1002	New York-New Jersey	AO–71–A83
1004	Middle Atlantic	AO–160–A72
1005	Carolina	AO–388–A10
1006	Upper Florida	AO–356–A33
1007	Southeast	AO–366–A39
1012	Tampa Bay	AO–347–A36
1013	Southeastern Florida	AO–286–A43
1030	Chicago Regional	AO–361–A33
1032	Southern Illinois-Eastern Missouri.	AO–313–A42
1033	Ohio Valley	AO–166–A66
1036	Eastern Ohio-Western Pennsylvania.	AO–179–A60
1040	Southern Michigan	AO–225–A47
1044	Michigan Upper Peninsula	AO–299–A30
1046	Louisville-Lexington-Evansville.	AO–123–A68
1049	Indiana	AO–319–A43
1050	Central Illinois	AO–355–A30
1064	Greater Kansas City	AO–23–A63
1065	Nebraska-Western Iowa	AO–86–A52
1068	Upper Midwest	AO–178–A50
1076	Eastern South Dakota	AO–260–A34
1079	Iowa	AO–295–A46
1106	Southwest Plains	AO–210–A56
1124	Pacific Northwest	AO–368–A26
1126	Texas	AO–231–A64
1131	Central Arizona	AO–271–A34
1134	Western Colorado	AO–301–A25
1135	Southwestern Idaho-Eastern Oregon.	AO–380–A16
1137	Eastern Colorado	AO–326–A29
1138	New Mexico-West Texas	AO–335–A40
1139	Great Basin	AO–309–A34

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Final decision and termination of proceeding.

SUMMARY: We are denying a proposal to establish a price floor under the Basic Formula Price (BFP) used to calculate Federal milk marketing order prices for Class I and Class II milk, and we are terminating the rulemaking proceeding The record does not justify establishing a price floor, given the current and projected supply and demand for milk. The price floor would have unequal effects in different regions of the country, even for farms of similar size, because of different Class I milk utilization rates. As a result, those who would benefit the most from a price floor would not necessarily be the farms that have the greatest financial need for such assistance.

FOR FURTHER INFORMATION CONTACT: Constance M. Brenner, Marketing Specialist, USDA/AMS/Dairy Programs, Order Formulation Branch, Room 2971, South Building, P.O. Box 96456, Washington, DC 20090–6456, (202) 720–2357, e-mail address Connie__M__Brenner@usdagov.

SUPPLEMENTARY INFORMATION: This action is covered by Sections 556 and 557 of Title 5 of the United States Code and, therefore, is excluded from the requirements of Executive Order 12866.

Small Business Consideration

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service (AMS) has considered the economic effect of this action on small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a small business if it has annual gross revenue of less than $500,000, and a handler is a small business if it has fewer than 500 employees. To determine which farms are small businesses, we determined that the $500,000 annual revenue criterion equals 326,000 pounds of milk production per month. A small plant will be considered a large business if it is part of a company with more than 500 employees.

AMS analyzed the regulatory impact of the proposal on small entities and determined that adoption of the proposed $13.50 floor would have unequal effects on similar-sized farms in different regions of the country because of differences in Class I milk utilization rates, and that it would benefit the largest farms most. During the effective period, the floor would have increased the average gross Class I price by $1.05 per hundredweight (cwt). The benefit to an individual producer would have depended on the blend price under the order in which the producer's milk was pooled. The blend price is the weighted average of all revenues from all uses of milk in the order area. So, a producer whose milk is pooled under an order with high Class I use of 80 percent would receive $0.84 of the overall $1.05 per cwt. On the other hand, a producer whose milk is pooled under an order with low Class I use such as 20 percent would only receive an additional $0.21 per cwt.

This means that, for a small farm in Wisconsin with 60 cows, average revenues would increase by only $630 for the last half of 1998 because the blend price would increase only $0.14 per cwt. The same size farm in New York would receive $0.48 per cwt, or $2,160 more revenue for the same period. The difference is caused by the higher percentage of Class I use in the order covering New York.

For a medium-sized farm in Texas with 400 cows, the average revenue increase would be $23,040, based on a higher blend price of $0.64. However, because of differences in blend prices, the same size farm in Illinois would receive over $40,000 in additional revenue over the last half of 1998.

Finally, for a large 2,000-cow farm in New Mexico, average revenues would increase by $72,000, based on a higher blend price of $0.36, while the same size farm in Florida would have average revenues increase by $216,000. Again, this difference is due to a higher percentage of Class I use in Florida than in New Mexico.

Clearly, farms in higher Class I utilization markets, or large farms, would have benefited more than farms in markets with lower Class I utilization, or small farms, regardless of financial need.

Because this action terminates the rulemaking proceeding without amending the present rules, the economic conditions of small entities will remain unchanged. Also, this action does not change reporting, record keeping, or other compliance requirements.

Economic Analyses

The Notice of Hearing in this proceeding contained an Initial Regulatory Flexibility Analysis and a Preliminary Cost-Benefit Analysis. We analyzed the effects of adopting the proposal using March 1998 projections of milk production, use, and prices. The analysis, and a description of the economic model used in the analysis, are available in the Regulatory Impact Analysis (RIA) of Establishing a Price Floor Under Class I Milk Marketed Under Federal Milk Marketing Orders, and can be obtained from Dairy Programs at (202) 720–4392, any Market Administrator office, or via the Internet at http://www.ams.usda.gov/dairy.

Prior document in this proceeding:

Notice of Hearing: Issued January 21, 1998; published January 26, 1998 (63 FR 3667).

Preliminary Statement

The United States Department of Agriculture (USDA) held a public hearing to consider proposed amendments to all marketing agreements and orders regulating the handling of milk. The hearing was held at Washington, D.C., between February 17 and 20, 1998.

The deadline for post-hearing briefs on the proposal and on whether the proposal should be considered on an expedited basis was March 11, 1998.

The issues of the hearing were:

1. Should we adopt a floor under the Basic Formula Price (BFP) used to compute the Federal milk marketing order Class I and Class II prices?

2. If such a floor were adopted, should it be implemented on an emergency basis?

Findings and Conclusions

We have adopted the following findings and conclusions relating to the material issues of this proceeding:

1. *Should we adopt a floor under the Basic Formula Price used to compute the Federal milk order Class I and Class II prices.* A proposal by Mid-America Dairymen, Inc., (now part of Dairy Farmers of America, or DFA) would establish a $13.50 per cwt. floor under the Basic Formula Price (BFP) for Class I and Class II milk. The proposed floor would remain in effect only until the Federal milk marketing order reform process is complete, no later than April 4, 1999. Proponents urged that the proposed floor be adopted on an emergency basis, without first issuing a recommended decision. The record does not contain sufficient evidence to adopt the proposed pricing floor, as explained below.

Fourteen U.S. dairy farmers and seven representatives of cooperative associations spread across the country testified in support of the proposal, saying that the current BFP does not accurately represent the value of milk used in manufactured products, that volatility in farm-level milk prices has damaged producers, and that many producers are in debt and in danger of financial failure. According to proponents, prices paid to producers in recent years have been below the costs of producing milk, making it hard for the U.S. dairy industry to ensure an adequate supply of milk for fluid use. Proponents testified that producers are earning returns that are less than the minimum wage, and that price volatility makes planning and budgeting nearly impossible.

The proponents argued that the brief duration of the proposed floor price would make it unlikely that increased prices would lead to increased production. In addition, they stated that such a floor would not necessarily cause higher prices to consumers. The witnesses acknowledged that, while retail milk prices generally rise when prices to producers rise, retail prices do not fall by the same amount or as fast as falling farm prices. According to one cooperative association representative, the recent volatility of milk prices has increased the margin between farm and retail prices. The witness stated that it is important, therefore, to establish a BFP floor while the BFP is relatively high to avoid having middlemen increase retail margins further after the BFP declines.

The proponents noted that feed costs, which make up approximately 50 percent of the cost of producing milk, have risen while the price of milk has not risen comparably. They also stated that other production costs, such as supplies and utilities, are also increasing at a much faster rate than milk prices to producers, which have changed little in 20 years.

The proponents also said that handlers are paying producers more than minimum Class I order prices for milk used for fluid use in order to insure a sufficient supply for most markets. The larger payments, they said, are evidence that Class I differentials under the orders are not high enough. The Northeast Interstate Dairy Compact (the Compact), which has established a $13.70 floor under Class I prices, and Maine's state-regulated prices were cited as examples of effective programs. A witness stated that Maine's price level is enhanced by $1.00 under State regulation while, at the same time, Maine's consumers enjoy low prices. The Vermont Commissioner of Agriculture argued, in a brief, that the Compact has not harmed retail sales or boosted production. Several witnesses stated that the proposed floor under Class I and II prices would provide some price stability for producers, and help dairymen stay in business.

Six dairy farmers and a representative of a national farmers organization testified that they support a $14.50 price floor for all milk uses. They said that such a level would not cause burdensome production increases. Additionally, a brief filed on behalf of a cooperative association argued that a $14.00 floor on all milk would reflect the minimum cost of producing milk. A business that supplies hay to dairy farms recommended a $14.50 floor for both Class I and II milk.

Proponents noted a decline in the number of dairy farms and, in some regions, declining production, as factors that severely affect small firms that do business with dairy farms, such as those that provide feed, equipment, and veterinary service. When the number of dairy farms in a region declines below a certain level, they testified, these small businesses disappear, making it more difficult for milk production to continue.

A DFA witness stated that domestic use of milk was greater than domestic production during 1997. The witness projected that per capita consumption of dairy products would increase by 5 pounds per year for the near future, and that DFA expects the milk production shortage to worsen if no action is taken to increase revenue to producers.

The Louisiana and Mississippi Commissioners of Agriculture, a Louisiana State Senator, and an Extension Service dairy economist from Louisiana State University testified that their dairy industries are in desperate straits, marked by a decrease in the number of dairy farmers and milk production. They favored adopting the proposed floor for a short period to provide stability for dairy farmers, until milk marketing order reform is completed. These witnesses said that many young people see no future in dairy farming, and are not becoming dairy farmers.

A brief filed on behalf of a cooperative association argued that the proposed floor would not interfere with the operation of futures markets. Even if it did, the brief concluded, the interests of futures markets should not be preferred over the interests of dairy farmers. According to proponents, the pilot program recently announced by USDA to encourage producers to use risk management tools to minimize their exposure to price volatility would affect producers in only 36 counties nationwide, and should not be a reason to deny the BFP floor proposal.

Most of the witnesses supporting adoption of a Class I price floor also supported such a floor for the Class II price. The proponents argued that Class I and II prices currently move together based on the BFP for the second previous month, that products in both classes often are marketed and distributed together, that products in both classes are perishable, and that the use of milk in both classes is driven by consumer demand.

However, several cooperative association representatives expressed reservations about adopting a floor under the Class II price because regulated handlers who process Class II products compete with unregulated handlers. Because they could make more money, handlers who process milk for Class II use might use nonfluid ingredients rather than fluid milk if the Class II and III or III–A prices differ by a large amount.

One Northeast Class I handler representative reluctantly supported the proposed floor for Class I milk only, but generally opposed decoupling prices for Class I milk from the value of milk used in manufactured products. The witness argued that the New York milkshed needs to be more competitive in pricing Class I milk relative to milk in the Compact region, and that the interim Class I pricing stability needs to be ensured in case Federal order Class I differentials are invalidated by court action before the conclusion of the Federal order reform process.

Two New Mexico producers opposed the floor but testified that the current BFP does not fully reflect the value of Grade A milk used in manufactured products. A New Mexico producer organization argued in a brief that replacing the current BFP with a price series that tracks both Grade A and Grade B prices for milk used in manufactured products would result in more accurate Class I prices, would increase income to farmers, and would better reflect market forces. A New Mexico dairy farmer testified that high-quality milk from very large farms can be delivered regularly between regions and arrive at its destination sooner, and fresher, than locally produced milk that is picked up at the farm every other day.

Opponents of the price-flooring proposal included two witnesses representing upper Midwest producers, a Midwest cooperative association representative, the Wisconsin State Secretary of Agriculture, the Minnesota State Commissioner of Agriculture, and two University of Wisconsin dairy economists. They contended that the proposal would have a negative effect on upper Midwest dairy farmers, and would not affect U.S. producers equally because of different Class I utilization between regions. They stated that enhancement of Class I prices would increase production and reduce Class I use nationally, reducing returns to upper Midwest producers as a result of lower prices paid for milk used in manufactured products. In addition, they argued, flooring Class I and II prices would shift more price volatility to the manufacturing markets. The upper Midwest witnesses stated that the number of dairy farms in the upper Midwest is declining, threatening the existence of the dairy processing industry, and argued that adopting the proposal would hasten the decline of the upper Midwest dairy industry.

They argued further that the average BFP has not been above $13.00 for some time, and is not projected to reach the proposed floor level during the proposed period. One upper Midwest witness also stated that production and demand are in balance nationally, and are expected to remain so for the foreseeable future. These witnesses argued that Federal orders were not intended as a price support system, and should not be so used.

Twenty representatives of milk processors, including 12 representatives of processors of Class II products, also testified in opposition to the proposal. They argued that current national milk production is in balance with consumption of dairy products and is projected to remain so. Any price increase not justified by the supply/demand interaction reflected in the BFP almost certainly would stimulate production, which would divert large surpluses of milk to manufactured product markets, they said. This, they argued, would drive down prices of milk used in manufactured products, even as the proposed floor would increase costs of fluid milk to consumers and reduce its consumption. Further, they argued that adopting such a floor for Class I and II prices would hurt dairy industry efforts to create export markets for value-added dairy products.

Most processors and some producer organizations opposed a pricing floor on Class II milk. Opponents stated that Class II products are processed in plants that also process fluid milk products and are fully regulated under Federal milk marketing orders, or in plants that process only one or two Class II products and are not fully regulated. Members of the Class II milk processing industry argued that, if fully regulated handlers processing Class II products are subject to a floored Class II price, they will not be able to compete with handlers who are not subject to Federal order pricing, such as California handlers.

Class II milk processors stated that flooring the BFP for Class II milk may cause handlers to switch to nonfat dry milk and butter as ingredients in such products as ice cream, cottage cheese, and yogurt. They argued that fluid milk that would have been used in these products would be shifted to lower-valued manufacturing uses. They concluded that producers, therefore, would lose revenue.

The milk processor representatives claimed that current efforts to encourage the use of futures contracts, as well as USDA's pilot program for risk management for dairy farmers, would be meaningless if the floor were adopted. They argued this because, they claimed, a major portion of the U.S. milk supply would be without price risk, as the proposed price floor of $13.50 would be higher than any of the futures options for the period for which the floor is proposed. They argued that futures and options on futures are market-oriented pricing tools for producers and the industry to manage risk and stabilize revenues in a less regulated market.

A milk processor representative opposed flooring the Class I price because the resulting increase in producer prices would not be pooled nationally. Another milk processor stated that the declining number of farms is affecting the dairy processing industry, but concluded that this does not mean that there will be a shortage of milk.

Two representatives of consumer organizations testified that the proposed floor would increase prices of fluid milk to consumers, reduce fluid milk consumption, and increase government program costs for the school lunch program and the Special Supplemental Program for Women, Infants and Children.

Several opponents indicated that proponents' argument for flooring was based on the faulty premise that Federal milk marketing orders should insure an adequate supply of milk for all uses, instead of for fluid use only.

Conclusions

Despite a 46-percent reduction in the number of U.S. dairy farms from 1988 through 1997, milk production increased 8 percent. The data contained in the record of the public hearing in this proceeding provide no basis to expect that an adequate supply of milk for fluid use will not be available nationwide. Therefore, the record does not support adopting the proposal, which would encourage more milk production.

Proponents argue from USDA statistical data that consumption of dairy products exceeded commercially marketed milk in 1997, and that the gap between consumption and production will continue to grow. We have concluded, however, that the data in fact demonstrate that production and consumption are in balance. Milk production increased by 11.3 billion pounds from 1985 to 1996. During the same period, commercial use increased by 24.5 billion pounds as prices decreased and annual net removals (USDA purchases) declined by 13.1 billion pounds. When the USDA price support program ends on December 31, 1999, USDA projects that imports will remain flat through 2007 and growth in use will come from increased milk production.

DFA's projection that consumption will exceed production by a widening margin through the year 2010 is derived by extending the 1985–1996 trends in milk consumption and production. However, extending these two independent trend lines into the future ignores the ongoing interaction between milk prices, supply, and demand.

USDA baseline projections of milk production and commercial use through marketing year 2007/08 indicate continued balance between production and use, with no sharp increase in farm or retail milk prices that would accompany a shortfall in milk production.

National milk production has increased by 8 percent since 1988 while the U.S. population has increased by 7.3 percent. The hearing record provides no evidence that milk production will not continue to keep pace with population growth and the increase in demand for fluid milk. There is even less evidence to show that there is now or will be a national shortage of fluid milk over the next several years.

Based on the March 1998 USDA economic analysis referred to earlier in the Economic Analyses section of this document, the percentage of milk in Class I use may decrease by approximately 0.2 percent for the period that the floor would be in effect, with minor changes from the baseline through 2002.

USDA analysis of the proposed floor for Class I prices indicates that commercially marketed milk production would increase by approximately 0.11 percent during the period the floor would be in effect. Commercially marketed milk production would increase an additional 0.09 percent through 2002. This additional milk production would result in the increased manufacture of dairy products in lower-priced classes, primarily in the areas of the country where more milk is used in manufactured dairy products than in fluid products.

The proposed floor under Class I and II prices would have unequal effects on farm-level milk prices unrelated to the financial need of the farmers affected. The benefit of the proposed floor to a producer would depend on the proportion of Class I and II milk used in the order in which the producer's milk is pooled. Thus, a producer whose milk is pooled under a marketing order with a relatively high 80 percent Class I and Class II use would get 80 percent of the projected $1.05 difference between the proposed floored price and the projected BFP for the last half of 1998 and early 1999, or $0.84 per cwt. On the other hand, producers in marketing order areas with a relatively low 20 percent Class I and Class II use would receive the benefit of only $0.21 of the $1.05 increase in class prices. Producers in high Class I use areas already receive higher blend prices for their milk than producers in areas with lower levels of Class I use, and the effects of the price floor proposal would widen the differences between such areas.

The higher Class I and II prices would also increase milk production and reduce fluid milk consumption, which would lower prices for milk used in manufactured dairy products. Lower prices for these other classes of milk would be even more detrimental to producers in low Class I and II utilization markets.

The petition for flooring the BFP is denied because there is no evidence of a national milk shortage, either for all uses or for fluid uses. Furthermore, flooring the BFP would have widely varying effects in different regions of the country unrelated to the financial need of farmers. In addition, flooring the BFP to establish Class II prices is denied because it would interfere with competitive relationships within the industry. The record indicates that most handlers who manufacture Class II products can easily switch to nonfluid ingredients, such as butter and nonfat dry milk when they are less costly than fluid milk. Even handlers who cannot make the switch immediately may nonetheless find that a shift to nonfluid ingredients might be in their long-term interest. The substitution of lower-valued nonfat dry milk and butter for fresh milk valued at the higher Class II price could result in the loss of Class II revenues to farmers.

2. *If such a floor were adopted, should it should be implemented on an emergency basis?* Proponents of the BFP floor proposal urged that USDA take emergency action to make the Class I and II price flooring action effective as soon as possible. They stressed that dairy farmers need immediate price relief, and they emphasized the importance of establishing a floor before the BFP declines. According to the proponents, adopting the floor when the BFP is at a relatively high level, rather than when the BFP has fallen seasonally, would eliminate the incentive for wholesalers and retailers to raise prices to consumers.

Opponents of the proposed pricing floor argued that no emergency exists, and that there is no evidence that milk supplies are threatened in the near or distant future.

The facts clearly demonstrate that the proposed floor is not required by supply and demand conditions. Further briefing or argument would not change these facts, but would only cause further uncertainty in the industry. Therefore, this decision denying the proposal is issued on an expedited basis to let producers and processors know that the proposed floor is not approved.

Rulings on Proposed Findings and Conclusions

All briefs, proposed findings and conclusions, and the evidence in the record were considered in reaching the findings and conclusions set forth above. The petition to floor the BFP used to calculate Federal milk marketing order prices for Class I and Class II milk is denied for the reasons previously stated in this decision.

Our action makes it unnecessary to address legal arguments advanced in opposition to this proceeding.

Determination

Our findings and conclusions do not require any changes in the marketing orders regulating the handling of milk.

Authority: 7 U.S.C. 601–674.

Dated: June 9, 1998.

Kenneth C. Clayton,

Acting Administrator, Agricultural Marketing Service.

[FR Doc. 98–15775 Filed 6–10–98; 3:00 pm]

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