

Proposal

Submitted by

Ohio Farmers Union

Reconvened hearing on Class III & IV:

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Farm Milk Pricing Plan

The main advantage of a market system is the efficient allocation of resources. However, the efficient allocation of resources can only be accomplished when the pricing system effectively transmits price signals from original production through to the consumer.

Milk pricing has long been connected to the political process and since the mid-80s, farm milk pricing has been touted as more market oriented. As figure 1 illustrates, this is not true.

Price Indexes For Dairy 1957 - 2006

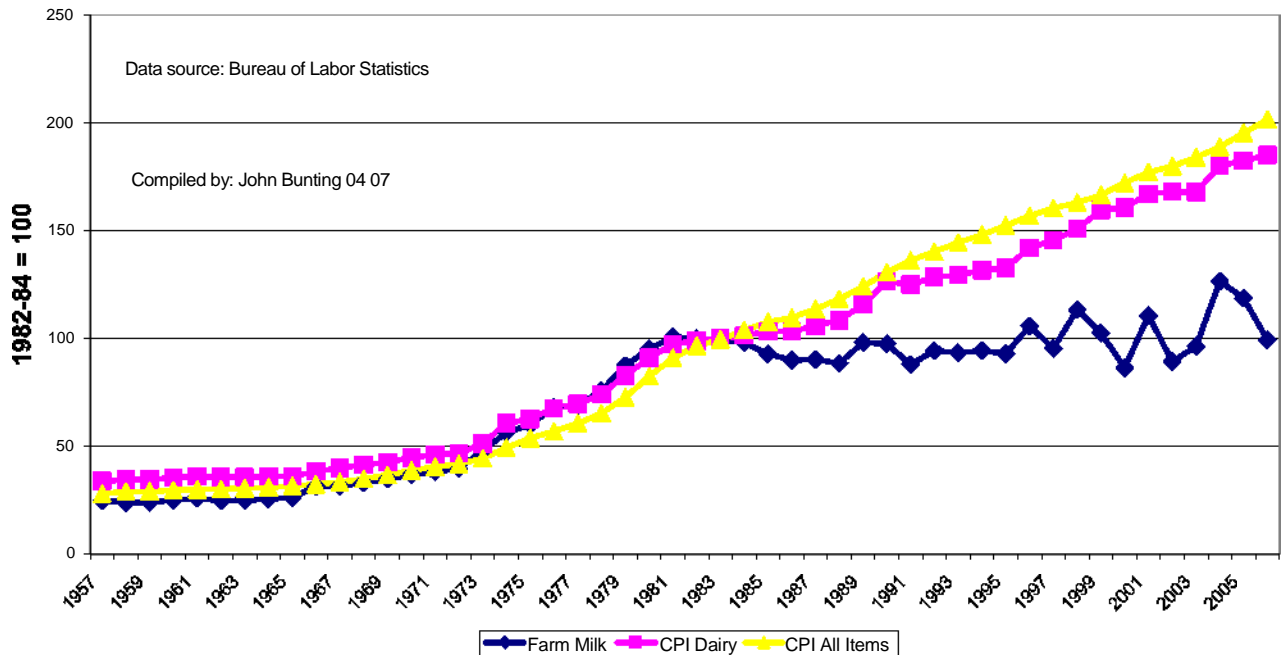


Figure 1

Prior to the early 1980s, as shown in figure 1, farm milk price and retail dairy price roughly followed the Consumer Price Index for all items. With the elimination of parity, farm milk price signals ended their correlation to retail dairy prices.

Farm milk pricing, although appearing to be complex, is simply a government formula attached to the trading of cheese, presently at the Chicago Mercantile Exchange (CME). It is a matter of fact that 100% of the variability in farm milk price can be traced to trading at the CME. Buyers of raw farm milk deserve a voice in the market, but it should not be the only voice.

Before parity was eliminated, milk production was dispersed throughout the country, although there were traditional, pastoral dairy regions that were more dense. Since parity was eliminated, milk production has followed an industrial model. In large part, the industrialization of dairy was financed through capital obtained from suburban Los Angeles real estate, and consequently growth has focused in four Western states. As long as energy remained cheap, growth of milk production in Western states could be rationalized.

According to a USDA Economic Research Service publication, “The objective of FMMOs (Federal Milk Market Orders) is to promote orderly milk marketing relationships to ensure adequate supplies of milk and dairy products to meet consumers’ demands at reasonable prices.”¹ The same document also states that reduction in the number of FMMOs in 2000 was “to better reflect movements of milk, natural market boundaries, and existing institutional or market arrangements. It also made changes to pricing provisions to provide incentives for greater structural efficiencies in the assembly and shipment of milk for fluid milk products.”

Prudent leadership recognizes that long-term trends are not always in the public's interest. In general, the public has an interest in a dispersed, regional, and resilient milk supply. Although 7 USC §608 (c) 18 specifically requires regional consideration, USDA's de facto policy has ignored §608 (c) 18 and perceives milk production purely in national, not regional terms.

The consequences of this policy are slowly beginning to unfold a realization of the future cost to the public. The densely populated eastern section of the United States has steadily lost milk production. No one can say with certainty what the long-term effects of this policy will be; however, enough is known to realize the policy is not prudent.²

<p>First Half of 2006 Per Capita Milk Production U.S. Average = 312 Lbs. Less Than 150 Lbs. = 21 States 150 To 300 Lbs. = 9 States Greater Than 300 Lbs. = 18 States</p>
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Thirty out of forty-eight states do not have production to meet demand.

¹ <http://151.121.68.30/publications/ldp/2006/07Jul/ldpm14501/ldpm14501.pdf>

² <http://www.fmmacentral.com/PDFdata/msb200607.pdf>

Proposal

A three-pronged pricing system creates an effective framework to ensure a diverse, regional, safe supply of milk. One part considers the regional cost of production for milk. The next part would be a price signal from processors. The third would consider prices to consumers.

Regional cost of production data is now collected by USDA Economic Research Service. A price signal from processors is presently generated by block Cheddar cheese trading at the Chicago Mercantile Exchange. Other spot market prices could be used. The Bureau of Labor Statistics collects data presently for natural Cheddar. Therefore all of the data for this pricing plan presently exist and would require no further outlay or effort.

It should be noted that California at one time had a three part pricing system which included an inflation factor determined by labor cost. The Bureau of Labor Statistics data on retail Cheddar would be used in a similar fashion. That is to say, the retail price is not transferred but rather used as a basis.

To balance the price to processors a national pool would be created similar to the federal order pool for blend price. Processors in high-cost areas would then be able to draw from the pool thereby causing no unnecessary processor burden.

Specifically, this pricing plan would take one third of the regional cost of production, to which would be added, CME block price times a yields factor, and the retail price of natural Cheddar published by the Bureau of Labor Statistics times a yields factor. The yield factor is the standard yield of cheddar cheese per hundred weight of milk.

A new yields factor should be determined based upon current technologies. Following the traditional Van Slyke yield formula is no longer viable.

The number obtained could be adjusted by the Secretary of Agriculture from 60 to 100% based on regional milk production.

Regional milk production goals would need to be determined based upon a balance between optimizing regional self-sufficiency and the overall cost. The overall cost would have to consider future energy availability, and pollution generated by transportation.

<p>Formula: $\frac{1}{3}$ each (ERS determined regional cost of production) + (CME Block Price x Yields Factor) + (Retail price of natural Cheddar determined by Bureau of Labor Statistics x Yields Factor) = Farm Gate Milk Price at 3.5% Butter Fat & 2.9 % Protein</p>
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Components

This pricing plan recognizes the variation in farm milk product yield by adjusting the individual farm milk price for both a cheese yield and a butter yield. Both the cheese yield and the butter yield component differential would be a balance between the spot wholesale price and the price as reported by Bureau of Labor Statistics.

Classes

The above components would be used in determining price for manufactured dairy products. Fluid price, or Class I price, would be determined using differential concepts. Obviously, fluid milk has the highest location-based value. The present differentials do not fully consider the differential value. That value can only be determined by an analysis of three factors; the location of the producing farm in relationship to the processing plant and ultimately the relationship to the consumer base.

It is understood that the Cornell model considering the three factors for determining Class I differentials is being upgraded. Data from such a model should be used in determining Class I differentials.

Conclusion

This pricing plan is fully market oriented. Implementation of the plan would go a long way toward eliminating price asymmetry for dairy. Furthermore, this plan considers the importance of national security and the public's interest therein. The present pricing system totally ignores national security and the potential for animal pandemics enhanced by world trade.

The present pricing system has generated, according to some criteria, an efficient dairy product system. However, the facts which can be derived from existing data demonstrate that all of the efficiencies have been captured by those between the farmer and the public. The trend is disturbing. There is an undeniable public interest in a dispersed, resilient food supply system including dairy products.

Ohio Example (February 07)

	Listed Prices	Adjusted to Cwt	1/3 Value
Ohio Cost (ERS) ³	28.42	28.42	9.474642
CME Block Average	1.3408	13.408	4.469333
BLS Cheddar	4.013	40.13	13.37667

	Farm Cwt Price
100%	27.32064
90%	24.58858
80%	21.85651
70%	19.12445
60%	16.39239

³ <http://www.ers.usda.gov/Data/CostsAndReturns/testpick.htm#milkproduction>