

GAO cites concerns about potential manipulation

Now cheese price reporting comes under fire

Reprinted from *Farmshine* July 13, 2007

By SHERRY BUNTING
Special for *Farmshine*

WASHINGTON, D.C. – Dairy farmers have yet another reason to wonder if they're being paid what their milk is really worth... This time the questions center on cheese prices and the effect of "thin trading" and "potential manipulation" on the data used in setting federal order minimums for Class III milk.

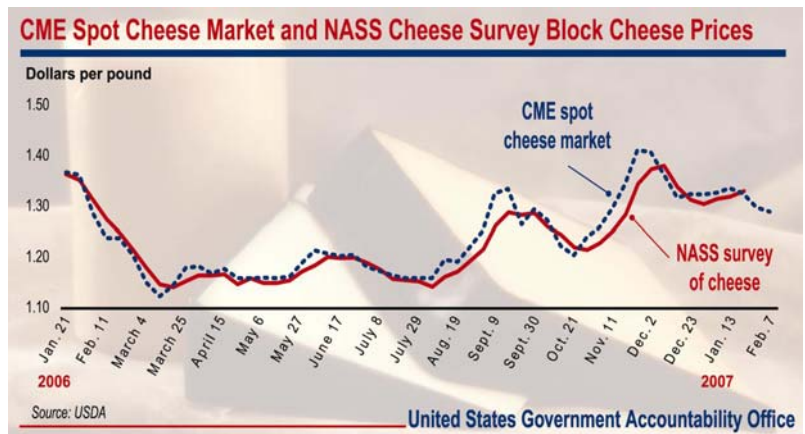
This week the U.S. Government Accountability Office (GAO) released a report headlining that "market oversight has increased but concerns remain about potential manipulation." GAO is the "investigative arm" of Congress, and the new report is the result of the department's yearlong review, requested by members of Congress in July of 2006.

"Because the CME (Chicago Mercantile Exchange) spot cheese market remains a market in which few daily trades occur and a small number of traders account for the majority of trades, questions exist about this market's susceptibility to potential price manipulations," the report says.

While the National Agricultural Statistics Service (NASS) survey of cheddar cheese prices is the data actually used in federal order milk pricing formulas, the "thinly traded" CME spot cheese market impacts the federal order minimum pricing because of the high correlation of CME trades to the NASS survey figures, according to the GAO analysis.

In particular, the CME spot prices are used to set long-term contracts, which are then captured by the NASS survey of cheese prices, the GAO report finds. USDA's Agricultural Marketing Service (AMS) uses the NASS survey instead of the CME, because it "captures" more transactions than what occur on the CME spot cheese market. But the two are closely correlated because of the large contracts involved and the use of the CME to set those contract prices.

The GAO report also observes that "...in addition to largely capturing CME price data, (the NASS survey) introduces a 1- to 2-week time lag between when data are reported by NASS and when certain transactions captured in the survey occur." The report also highlights the point that the NASS survey is not currently audited to ensure the accuracy of the information.



“These factors may contribute to milk prices paid by dairy market participants that are either not completely accurate or not current,” the GAO report concludes.

The report acknowledges increased oversight by the CME and the Commodity Futures Trading Commission (CFTC), in the form of daily surveillance and regular reviews of trading data and market trends. However, CFTC oversight is not the same thing as verification or auditing of data supplied by plants to the NASS survey. Trading oversight also does not address market structure issues.

Here’s what the GAO is recommending. 1) USDA should seriously consider all industry proposals, including one to eliminate the NASS survey of cheese prices, in the minimum federal milk pricing formula. 2) If USDA continues to use the NASS survey, the GAO is recommending that USDA audit the survey data. In its recommendations, GAO fell short of calling for an audit of previously reported prices.

USDA, in written comments to GAO, has agreed to audit the survey data, but it has not agreed to proactively consider a proposal to eliminate the NASS survey. USDA has indicated to GAO, that it would give “due consideration to all industry proposals.”

GAO was asked (by Congress) to examine 1) the market’s structure and ongoing concerns about price manipulation; 2) market oversight and efforts to address potential manipulation; 3) how the market impacts federal milk pricing.

In response, GAO compared the markets at the National Cheese Exchange (NCE) in Wisconsin with the CME, analyzed the trading data, collected information about the CFTC oversight, and met with industry participants, academics, and agency officials.

GAO’s analysis of the situation raises new questions about potential manipulation of cheese prices on the CME, leading to those prices being reported to the NASS survey and then subsequently used in setting federal order milk price minimums.

###