

## **Part III of DOJ/USDA hearing in Wisconsin**

# **Market consolidation and lack of transparency linked**

**By SHERRY BUNTING**  
**Special for Farmshine—July 16, 2010**

MADISON, Wis.—After the first panel of experts discussed the trends in the dairy industry and the efficiencies gained through consolidation at the retail, processing and marketing levels, the over-riding concern revealed is the spread between what consumers pay for dairy products and what the farmers receive for their milk.

The second panel during the June 25 USDA / Department of Justice (DOJ) hearing at the University of Wisconsin-Madison focused on “market consolidation.” Information and perspectives were brought to the table by Brian Gould, associate professor of agriculture and applied economics at the University of Wisconsin; Calvin Covington, retired dairy industry executive, formerly with Southeast Milk; Louise Hemstead, CEO of Organic Valley cooperative; Dan Smith, former Northeast Dairy Compact administrator; and John Wilson, senior vice president of Dairy Farmers of America (DFA) cooperative.

Gould detailed a dairy industry that has undergone “major changes.”

The number of dairy cooperatives maxed out at 2200 after World War II, he explained. Together, they had 40% of the milk market at that time, and the remainder of milk marketings were independent producers.

By 1980, there were 435 cooperatives with 77% of the market. And by 2007, there were 155 cooperatives with 82 to 83% of the market.

According to Gould, the 1960s and 70s brought the trend toward local cooperatives consolidating to become larger regional cooperatives. And in 2001, a Government Accountability Office (GAO) showed these cooperatives continued to grow and to consolidate through mergers with DFA and Land O’Lakes as well as through the use of Marketing Agencies In Common (MAIC).

The purported reason for this level of consolidation in milk marketing is to “meet the needs of larger processors and the larger final purchasers,” said Gould.

Using two indexes that measure concentration and market share, Gould showed the “HHI concentration index” score for cooperative milk grew from “extremely low” in 1987 to a “moderate” score in 2002.

DFA’s John Wilson touted the cooperative’s diverse membership and that cooperatives, by their nature, are voluntary organizations. As cooperatives merged, he said, efficiencies are gained, particularly in hauling, moving and balancing of the milk supply.

Calvin Covington, formerly an executive for 10 years with Southeast Milk, Inc., based in Florida, said the main challenge they have faced is in finding fluid markets for producers.

“As other processors merged or were forced to sell, we had to buy plants to have local markets,” he said. “By necessity, we moved from a marketing cooperative to a processing cooperative.”

To balance that market, Southeast Milk built an ultrafiltration plant in Georgia, where 25 to 30% of the cooperative’s milk is handled and prepared for shipment as “liquid MPCs” for cheese plants and other manufacturing sectors to the North and West.

Dan Smith discussed the dynamics of the Northeast fluid milk market, also focusing on the wide price spread between the farm and the consumer. He addressed the advent of Dairy Marketing Services (DMS), which took on what used to be the presence of smaller marketing cooperatives throughout the Northeast.

“The concentration at the processing and marketing levels are a direct response to retailers,” said Smith. “In essence, concentration at the supermarket level has transformed the New England retail market. The ‘big box’ stores push out the conventional stores.”

He showed how this transformation has followed through to every sector, and he said the impact is felt mostly on how young people will enter the dairy business.

As Covington noted, “Part of the problem is that our pie is not getting any bigger so everyone is chasing the same piece.”

During the last panel of the day, the topic turned from market consolidation to market transparency.

Bob Yonkers for the International Dairy Foods Association (IDFA) said that, “In the dairy industry, we really don’t have price discovery for farm milk. We have price discovery for cheddar cheese, butter, and nonfat dry milk, and those prices are used by USDA to regulate farm milk prices. There are fewer buyers and sellers in each individual marketplace, than for farm milk overall.”

The problem with more frequent reporting, said Yonkers, is that there are not very many buyers and sellers to have robust price discovery.

Andy Pauline from the GAO said their studies show that 83% of the USDA-formulated milk price comes from the CME cheddar cheese price because the industry uses that price to set the prices that are captured by the NASS Survey.

“There is a 98% correlation between the two,” said Pauline. “In 2007, the GAO had recommended that USDA give consideration to some alternative proposals.”

Dennis Wolff, representing DPAC, focused on the daily electronic reporting as an alternative and a way to dilute the influence of the thinly-traded CME spot cheddar price.

“This is the cornerstone of any changes that happen, in federal dairy policy reform,” said Wolff. “We need to do that by diluting the influence of the CME. The small volume of dairy product that is traded on this exchange, has way too much impact. When you look at the fact that 0.4% of the cheese processed in the United States is being marketed on the CME, or less than 2% (1.7%) of the butter, and yet it is having this large of an impact on setting the price for a \$30-40 billion dollar industry and what the farms receive in their milk prices... That is concerning.”

Stephen Obie from the Commodity Futures Trading Commission (CFTC) agreed. He said surveillance of dairy markets is “very vigilant.” CFTC is in charge of regulating the futures markets, not the CME spot market (where the cheese is traded), but they do have some enforcement there if it relates back to positions buyers and sellers hold on the futures markets. CFTC can investigate cases tied to Class III milk futures.

He said open dialog with producers is important and he gave the toll free phone number for calling in a complaint: 866-FON-CFTC.

Obie also said people in the dairy industry want price discovery and that perceptions, themselves, can undermine confidence in the marketplace. “The cheese trade on the CME is not actively traded,” he said. “And that does concern me.”

*Stay tuned as this national conversation continues.*