PASSAGE *to* SUCCESS

FARM BUREAU - CONFRONTING THE ISSUES

Milk Pricing
AFBF Policy Development
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Issue: The Federal Milk Marketing Order system was created in 1937 to assist dairy producers and processors with milk marketing through pooling, classified pricing, and setting minimum pay prices for producers. Recognizing milk production and delivery systems have changed in the last 70 years, producers, processors, and policymakers are now wondering whether there is a better option than this system.

Background: Perishability, lack of product uniformity, seasonality of milk production and consumption, variety of products produced, geographic dispersion of dairies, processing facilities, and fluid demand centers make milk a unique commodity and inherently difficult to market and price. According to the USDA, the Federal milk marketing system was created to: 1) assure consumers of an adequate supply of wholesome milk at a reasonable price; 2) promote greater producer price stability and orderly marketing; and 3) provide adequate producer prices to ensure an adequate fluid milk supply. Federal orders intend to accomplish these goals through: a) **Pooling** - requiring regulated handlers/processors /cooperatives within a marketing area to account for their milk utilization by class, and b) **Classified pricing** – setting monthly minimum pay prices for milk and its components based on the products in which they are used: *Class I*-fluid, *Class II*-soft products like yogurt, Class *III*-hard cheeses, *IV*-butter.

Many in the dairy industry do not believe the current system is reflective of the sector in 2009. The growing role of international markets, new processing technology and capacity, and increasing use of forward contracting by producers may make this system outdated. In addition, the complex and contentious formulas for the 10 existing orders complicate milk pricing and price discovery. Only 60 percent of all milk is actually pooled into the 10 orders across the country at the present time.

Over the years, changes to federal orders and milk pricing have been made; orders were legislated to be flexible enough to change with the markets. Orders have consolidated (from 33 to 10 most recently) and pricing schemes have changed over time. However, some argue for abolishment of the system altogether on grounds that they distort markets. A single order system, which would have to be legislated in Congress, and include all states, could offer a comprehensive and centralized pricing system, but many worry about a single order's ability to ensure production and plant capacity and deliver minimum prices. What is clear is that producers have seen increasing price volatility in recent years, and the current order and pricing scheme has not been able to counteract this trend. Cornell University Extension Economist, Mark Stephenson, lays out several alternative pricing options that include:

1) **Modify Current Product Price Formulas** – Right now, milk prices are determined by back-calculating an implied value for milk from the products made from that milk over a set time frame. Product prices, make allowances (the price of processing milk that is included in milk pricing formula), and yield factors are components of price formulas and can be contentious. One option is to change the components within the formulas to better reflect the current conditions.

2) **Survey of Unregulated Milk** – In order to de-regulate the milk markets, the government could survey unregulated manufacturing milk sales in a particular market, such as the Upper Midwest, and base national prices on these surveys. While this would lessen the focus of fluid milk utilization, it could cause a price time lag in the rest of the country. This is similar to the previous pricing scheme based on the Minnesota-Wisconsin Grade B manufacturing price series but was ended due to lack of product in that market.

3) **Only Pool Differentials –** Under this scenario, all milk in all areas would be unregulated. Both manufacturing and fluid plants would have to negotiate prices with local suppliers and cooperatives, report those prices to a central authority, and then pay the difference in prices from a national average into a pool. Workability, existing USDA authorities, assuring equitable minimum prices, and integration with futures markets are concerns of this system.

4) **Futures or Spot Markets -** Many producers are beginning to market their milk in Chicago Mercantile Exchange (CME) futures markets. These prices could be used to set national pay prices or expanded to be the sole marketing entity. While price discovery would be improved, problems like delivering bulky products and perishability would still exist. Spot markets prices, like the current CME spot contracts, could be used to set prices; however, a national and neutral delivery point for milk would be problematic. Technology-assisted trading via the internet has been discussed.

Questions:

What would be the impact of elimination of the Federal Milk Marketing Orders? Would this be good or bad for dairy producers? Are ten orders sufficient or should the dairy industry consolidate to a single national order?

Would a comprehensive national milk pricing formula maximize return to dairy producers and decrease volatility in the marketplace?

What would an alternative dairy pricing structure look like? What would be the impact of potential alternative pricing mechanisms?

Are there other market-based approaches that would enable dairy producers to maximize trade opportunities?

Farm Bureau Policy:

Policy 229 – National Dairy Program
Line 2: [We support] (1) A market-oriented national dairy program….
Lines 6-7: [We support] (3) An expanded role for markets and private enterprise in establishing prices for all classes of milk;
Lines 10-11: [We support] (4) Modifications in the Federal Milk Marketing Order that will enhance the price of milk received by producers;
Lines 51-57: [We support] (20) A price discovery method which utilizes more milk and expands mandatory reporting and auditing of prices and inventories, including penalties for inaccurate reporting; and Improving price discovery through mandatory reporting and auditing of prices and inventories; and
(21) That a "no" vote on a referendum should not do away with the federal order.

Policy 328 – Federal Marketing Orders
Lines 1-2: Federal marketing orders should be designed to provide for orderly marketing and an even flow of high quality products to consumers.
Lines 7-25: Orders should not be used to control production directly, establish closed markets, maintain artificially high prices or collect funds for the purchase of agricultural products for diversion purposes. Any federal marketing order should meet the following criteria: (1) Be paid for and controlled by producers; within the bounds of the court; (2) Be used to maintain and expand markets; (3) Provide opportunity for new producers to enter the industry; (4) Contain a provision for periodic review through referenda to determine if the producers covered by an order favor its continuation; (5) Allow a minority of producers to petition for re-hearings or a new referendum; (6) Cover commodities which are produced for the same general market irrespective of the production area; (7) Provide that rejection of a proposed amendment shall not result in termination of the entire order; and (8) Provide for termination of an existing order only by producer referendum.