AFBF FEDERAL MILK MARKETING ORDER WORKING GROUP
BACKGROUND ON DAIRY INDUSTRY ADVISORY COMMITTEE
JULY 2019

Issue:

In 2009, following a sharp downturn in milk prices, USDA announced the establishment of a 17-member Dairy Industry Advisory Committee. DIAC members included dairy farmers, producer organizations, processors, consumers and academia, among others. The goal of the committee was to review issues facing the dairy industry, including volatility in farm milk prices and dairy farmer profitability.

In March 2011, the DIAC issued its final report to the Secretary, which included recommendations on how USDA can best address issues related to price volatility and dairy farm profitability. Two recommendations were specific to Federal Milk Marketing Orders. This background paper reviews those recommendations.

Background:

As directed in the Federal Advisory Committee Act, USDA established the Dairy Industry Advisory Committee in August 2009. On Jan. 6, 2010, Agriculture Secretary Tom Vilsack appointed 17 members to serve on the committee. Members were selected from a cross section of the dairy industry representing dairy farmers and cooperatives, producer organizations, processors and processor organizations, handlers, academia, retailers, consumers, and state agencies involved in dairy at the local, regional, national and international levels.

The DIAC was tasked to review "**farm milk price volatility and dairy farmer profitability. The Committee will provide suggestions and ideas to the Secretary on how USDA can best address these issues to meet the dairy industry's needs.**"

In March 2011, the DIAC issued its final report to the Secretary. Two recommendations were specific to Federal Milk Marketing Orders. These recommendations, the vote of DIAC members and the DIAC report language follow.

Review Federal Milk Marketing Orders - 17 in favor, 0 opposed, 0 abstaining

The Secretary should appoint a committee to review implications of FMMOs, including, but not limited to, end-product pricing's impact on milk price volatility and the impact of classified pricing and pooling on processing investment, competition and dairy product innovation.

Perspective from DIAC:

Although fluid milk processors are automatically subject to FMMO regulations and requirements, other dairy product manufacturers are not. Rather, those manufacturers

must demonstrate their capacity to supply milk to the fluid milk market to share in Class I milk price revenues. The performance or pool qualification requirements range from very easy to difficult across the various orders. If a manufacturer doesn't or can't meet these requirements, they must compete for milk on the basis of the blended price that farmers receive. However, their regulated counterparts have costs based on the minimum class price.

As the FMMO system is currently structured, "product formula" or "end product" pricing, based on mandatory dairy commodity survey prices, is used to determine minimum classified milk prices [AFBF Note: [Background on How Milk is Priced]]. For end-product pricing formulas, the spot prices for cheese and butter from the Chicago Mercantile Exchange aren't used in the formulas directly but do significantly influence milk prices [AFBF Note: [Background on CME Spot Market]]. CME prices are typically used by processors as a reference for price discovery and reduced margin risk. The CME spot market sees very little trading and can have large and unexpected swings. There is concern that these markets can be vulnerable to manipulation by a small group of traders, though CME and the Commodity Futures Trading Commission haven't found evidence of illegal manipulation.

There are other parts of classified pricing and pooling that could unintentionally incentivize farmers and processors and potentially reduce innovation. Processors pay milk prices that are referenced in classified prices, and these are tied closely to the finished product price. Other product manufacturers face risk when their prices and costs are significantly different from the price of the commodity. Basic commodity manufacturers have reduced margin uncertainty, making those commodities low-risk investments. The distortion in the market can discourage innovation, reduce market efficiency and result in a lower price for farmers.

Additionally, the original reasons for classified pricing and pooling may be obsolete. Improvements in technology and changes in consumer preferences have led to lower utilization of Class I fluid milk. Changes in milk transportation and storability, lower per-capita milk consumption, the establishment of very large farmer-owned cooperatives, and many other factors lead to a much-needed strategic look at the role of FMMOs in the future, and their place in setting prices and pooling.

Strongly Consider the Elimination of End-Product Pricing - 17 in favor, 0 opposed, 0 abstaining

Explore alternative measures to the current end-product pricing system, such as competitive pricing and mandatory price reporting.

Perspective from DIAC:

The committee was skeptical of the merits of the use of wholesale prices for certain dairy commodities to determine minimum milk prices under FMMOs. However, they

were not able to determine the best alternative to end-product pricing in the time they were given. The objective in eliminating this method of determining milk prices was to simplify dairy price regulation and develop a system in which all participants have confidence.

<u>Current Farm Bureau Policy:</u>

Farm Bureau supports:
- Modifications in the Federal Milk Marketing Order structure, formulas and price classes used to compute milk prices in order to better reflect current market conditions and enhance transparency and take into account the regional differences in the cost of milk production and incorporate multiple component pricing into all classes of milk; an economic analysis prior to any major revisions to the number of milk classes or Federal Milk Marketing Orders. This analysis should include economic impacts to the dairy industry and farmer income;
- A competitive pay price.