

DAIRY

Fact Sheet

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FEDERAL MILK MARKETING ORDERS

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Milk marketing orders are fundamental to all Texas dairymen since nearly all of them sell milk to processors regulated by federal orders. As a result, most Texas dairymen receive payment for their milk based on a price determined under a federal milk marketing order. Four federal milk marketing orders serve Texas (Figure 1). Formerly there were five orders, but the Red River Valley Order became part of the Texas Order as of the last quarter of 1982.

The Texas Order is largest. About 50 milk handlers receive an average of 3,000 pounds of milk per day from each of the nearly 3,000 dairymen selling milk to handlers in the Texas Order.

The Rio Grande Valley Order covers the El Paso area, most of New Mexico and a small portion of southern Colorado. Approximately 132 dairymen deliver an average of 10,000 pounds per farm per day to an average of 27 handlers selling milk in that order. About four of those handlers are located in Texas.

The Texas Panhandle Order covers processors selling in the Texas Panhandle and a small area of western Oklahoma. Approximately 95 dairymen ship an average of 3,000 pounds of milk per farm daily to two handlers covered by the order.

The Lubbock-Plainview Order includes two processors handling an average daily shipment per farm of about 5,100 pounds from 53 producers. In the former Red River Valley Order, approximately 138 producers ship an average of around 2,200 pounds per farm dairy to two handlers.

Definition

A federal milk marketing order is a legal instrument defining the terms under which milk handlers in the specified market purchase Grade A milk eligible for beverage use from dairymen. The terms of a marketing order specify a uniform system of pricing

milk according to use (classified pricing) for the market. The order provides for dairymen to share returns from all milk by pooling receipts and paying each dairyman an average price.

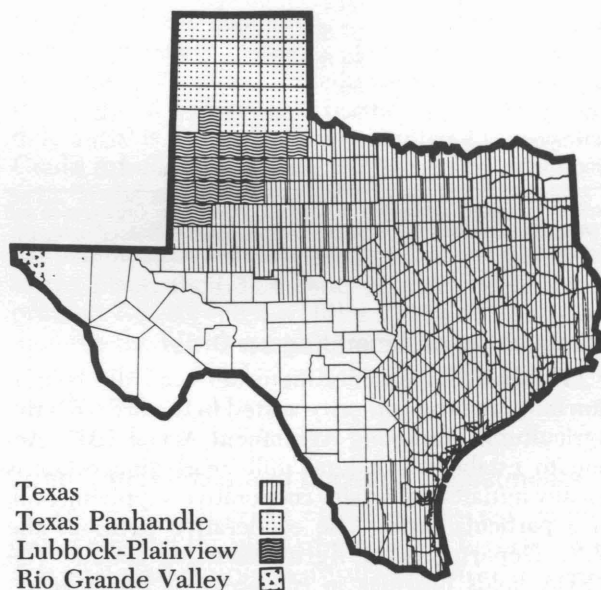


Figure 1. Federal marketing orders in Texas

Objectives of Federal Milk Marketing Orders

1) Federal milk marketing orders are developed to promote orderly marketing conditions. Orders assist dairymen in developing steady dependable markets for Grade A milk and help correct price instability and fluctuations. Raw milk production fluctuates seasonally with flush periods traditionally coming in the spring and early summer. By early fall and winter production tapers off (see Table 1). Handlers are assured of a milk supply as needed year round. Fluid

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milk sales are usually high in the fall and winter but decline during the early spring and summer (see Table 1).

2) Orders are developed to assure handlers that their competitors are not paying less for milk than the minimum price set by the order.

3) By creating price stability for dairymen and supply stability for handlers, orders are designed to assure consumers of an adequate supply of milk throughout the year.

Table 1. Seasonal index of average dairy deliveries per producer and in market sales of fluid milk for comparable Federal Order Markets. Average = 100 percent.

Month	Index of Producer Deliveries in %	Index of In-Area Sales in %
January	98.2	103.3
February	100.6	104.3
March	102.9	103.1
April	108.0	101.8
May	111.1	98.3
June	108.1	92.5
July	97.6	91.8
August	94.6	93.0
September	95.1	102.7
October	94.7	104.6
November	93.6	103.1
December	96.1	101.5

Source: "The Dairy Subsectors of American Agriculture: Organization and Vertical Coordination," NC Project 117 Monograph 5, College of Agricultural and Life Sciences. University of Wisconsin, November 1978.

Establishing or Amending an Order

The basis for establishing orders and the legislation outlining the authority vested in the orders is the Agricultural Marketing Agreement Act of 1937. Action to establish a federal milk marketing order is usually initiated by a dairy cooperative supplying milk in a particular area. The cooperative petitions the U.S. Department of Agriculture for action. The USDA holds hearings in the area. At the hearing, consumers, milk handlers and dairymen provide information necessary for the Department of Agriculture to determine if a marketing order is necessary and what its provisions should be. After reviewing the information collected at the hearing, the Secretary of Agriculture determines if an order is needed.

Producers associated with the order must approve a new order or an amended order before it may be issued. A new order providing for marketwide pools must be approved by referendum by two-thirds of the eligible voting producers or by producers who supplied two-thirds of the milk sold in the defined marketing area during the designated representative period. A bona fide cooperative may bloc vote its

membership on all questions involving new and amended orders except when voting on Class I base plans. Producers must vote individually on Class I base plans.

Classified Pricing

Marketing orders apply only to Grade A milk. Only Grade A milk meets health and production standards for fluid use, and only Grade A milk is eligible for bottling and selling as fluid milk. Fluid milk is the highest value use for milk. The order assigns a Class I price to milk utilized as fluid milk, a Class II price to fluid cream, Grade A milk used to manufacture other food products, cottage cheese, frozen desserts and baby formula. A Class III price is assigned to milk used for manufacturing cheese, butter and milk powder.

The Class I price in the Texas Order is the average price for manufacturing grade milk f.o.b. plants in Minnesota and Wisconsin as reported by the USDA and adjusted to 3.5 percent butterfat basis for the month two months prior to the month for which the Class I price is being calculated plus \$2.32. For example, if the Minnesota-Wisconsin price in December 1981 was \$12.56 then the Class I price in February 1982 would be \$14.88. Class II prices are estimated on trend. The Class III price is the Minnesota-Wisconsin price. The procedures for determining the prices are determined when the order is being established.

The Blend Price

Producers shipping milk to handlers regulated on a federal order are paid a minimum blend (uniform) price for their milk. The blend price is essentially a weighted average of the Class I, Class II and Class III prices. The weighting factors are the total quantities of milk used in each class over the entire market. The blend price is calculated for milk at 3.5 percent butterfat. The blend price is determined as follows:

Assume there are only three milk handlers being regulated in the market. Assume that Class I price is \$14.00 per hundredweight, the Class II price is \$11.50 per hundredweight, and the Class III price is \$11.40 per hundredweight.

Handler A reports the following monthly milk use:

Class I	30 million pounds
Class II	20 million pounds
Class III	10 million pounds

Handler B reports the following monthly milk use:

Class I	60 million pounds
Class II	40 million pounds

Handler C reports the following monthly milk use:

Class I	10 million pounds
Class II	10 million pounds
Class III	10 million pounds

The value of each plant's milk is determined as follows:

Handler A:

Class I		
30 million lbs. at \$14.00/cwt.	=	\$4,200,000
Class II		
20 million lbs. at \$11.50/cwt.	=	\$2,300,000
Class III		
10 million lbs. at \$11.40/cwt.	=	<u>1,140,000</u>
TOTAL		
60 million lbs.		\$7,640,000

Handler B:

Class I		
60 million lbs. at \$14.00/cwt.	=	\$8,400,000
Class II		
40 million lbs. at \$11.50/cwt.	=	<u>4,600,000</u>
TOTAL		
100 million lbs.		\$13,000,000

Handler C:

Class I		
10 million lbs. at \$14.00/cwt.	=	\$1,400,000
Class II		
10 million lbs. at \$11.50/cwt.	=	1,150,000
Class III		
10 million lbs. at \$11.40/cwt.	=	<u>1,140,000</u>
TOTAL		
30 million lbs.		\$3,690,000

Total pounds used by all three handlers	=	190 million pounds
Total value of the milk	=	\$24,330,000

The average price or minimum blend price for the milk:

$$\$24,330,000 \div 1,900,000/\text{cwt.} = \$12.805/\text{cwt.}$$

Pooling and the Producer Settlement Fund

The distribution of total returns to producers at the blend price is called pooling. The total value of the milk delivered by producers is called the pool.

Two types of pooling are used, the market-wide pool and the individual handler pool. In the orders covering Texas, a market-wide pool is used. In the market-wide pool, the total money value of all milk is contained in one pool. All of the producers who deliver milk to order plants are paid from the pool. All producers are paid the uniform blend price. The individual handler pool involves total producer deliveries to only one handler. A uniform price is determined for milk delivered to the individual handler. Calculations are essentially the same for the individual pool as for the market-wide pool but on a smaller scale.

Utilization values differ for handlers regulated by the same market, but all handlers pay the same minimum blend price for milk received. The difference between handler pay prices and utilization value is paid into a producer settlement fund. This results in the uniform blend price.

In the example, Handler A sold 60 million pounds valued by use at \$7,640,000. The value at the blend price is \$7,683,000. Handler A paid \$43,000 more for the milk it used than what it was worth in terms of how it was used by this handler. Handler B paid \$12,805,000 for milk valued by use at \$13,000,000. Handler B paid \$195,000 less than its milk was worth. For Handler C value of milk by use is \$3,690,000, or \$151,500 less than Handler C paid for milk. Handler A draws \$43,000 out of the producer settlement fund, Firm B pays \$195,000 into the fund, and Firm C draws \$151,500 out of the fund.

The Butterfat Differential

The minimum blend price applies to milk testing 3.5 percent butterfat. Dairy farmers are paid on the basis of actual butterfat test. The blend price is adjusted up or down depending on the number of 1/10 percentage points a farmer's milk is over or under the 3.5 percent standard. The adjustment factor is called the butterfat differential. In the Texas Order, the differential is determined by multiplying the monthly Grade A bulk butter price at Chicago by a factor of 0.12. If the monthly average Chicago butter price is \$1.31 per pound, the differential is \$0.157. Should a dairy farmer deliver milk testing 3.7 percent butterfat to the plant, then 31.4 cents is added to his blend price $(3.7 \times 10) - (3.5 \times 10) \times .157$. In the above example the blend price is \$12.805/cwt. The farmer would receive \$13.119/cwt. for his milk instead of \$12.805/cwt.

Zone Differentials and Location Adjustments

The minimum prices established by federal milk orders apply at the plant where milk is first received. A central market price is usually established for each marketing order. The order is divided into pricing zones and a zone differential is added to or subtracted from the central market price depending where the first receiving plant is located. The differential is added to all the milk delivered by a milk producer, but added only to Class I milk for a processor. For example, in the Texas Order, Dallas is the central market price quoted. Houston is Zone 8 of the Texas Order and as specified in the regulations of the order, \$.36 is the Zone 8 price differential. If the uniform price is \$12.81 as quoted in the central market, producers delivering to a Houston processor would receive \$13.17 for milk $(\$12.81 + \$.36)$. For calculating the value by utilization, the Houston plant would value Class I milk at \$14.36 $(\$14.00 + \$.36)$ if the

Dallas Class I price is \$14.00. Class II and Class III prices for the Houston plant are the same as the Dallas plant Class II and Class III price.

In some orders, a location adjustment based on mileage is used to determine price. A plant's pay price is adjusted based on the miles the plant is from the central market multiplied by a dollar rate per mile. The net effect is nearly the same as when zones are used.

Seasonal Pricing Plans

Some marketing orders (none of those in Texas) have base excess plans. One such plan is the Class I base plan to encourage producers to tailor their milk deliveries more to the Class I needs of the market. Under the plan, each producer is assigned a base which is a share of the market's Class I sales. The producer is paid a higher price for deliveries within that base and a surplus price for milk deliveries over the base.

A second type of plan is called a base-excess plan. The base-excess plan relates to the producer's total milk deliveries, not just Class I deliveries. Under a base-excess plan, producers establish a base equal to the average daily quantity of milk delivered during the short production season. Then, during the following flush season, dairymen are paid the base price for deliveries up to base and a lower price for milk deliveries over base.

The third plan is called a Louisville or take-out/pay-back plan. Under the plan, a specified amount of money is withheld in the flush season from proceeds due producers. The money is then paid to producers in the short supply season according to their deliveries.

Changing or Terminating Federal Orders

The short-run changes can be made by submitting proposals to the USDA for order amendments. The length of the process varies with the complexity and acceptability of the proposed change. Some changes take only months, others take years.

Long-run changes involve revisions in the Agricultural Marketing Agreement Act. Such proposals involve industry-wide input and support, evaluated as to impact on producers, milk handlers and consumer groups, and requires congressional action.

Actions suspending particular provisions may be taken without following the procedures in amending orders. Such action is taken only when there is a clear need for emergency action.

The 1937 Act allows a handler to challenge an order, any of its provisions or any obligation imposed, or to have an order modified or to be exempted from the order. Such challenges are made to an administrative law judge. If a handler is not satisfied with a decision at that level, the case may be appealed in Federal District court or ultimately the U.S. Supreme Court.

An order is terminated if a majority of producers supplying a market (over one-half the milk) vote in favor of termination.

Additional Reading

"The Federal Milk Marketing Order Program." Marketing Bulletin Nr. 27, Agricultural Marketing Service, USDA, June 1981.

Other Information Sources

Federal Milk Marketing Order 126, Market Administrator's Office, 11117 Shady Trail, P.O. Box 29529, Dallas, TX 75229

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