

# Texas Agricultural Extension Service

## DAIRY Fact Sheet

### FEDERAL MILK MARKETING ORDERS

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Almost all Texas dairymen sell milk based on a price determined by a Federal Milk Marketing Order. Four Federal Milk Marketing Orders serve Texas (Figure 1).

The Texas Order is largest. About 40 milk handlers receive an average of 5,500 pounds of milk per day from each of about 2,500 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 95 dairymen deliver about 18,500 pounds per farm per day to an average of nine handlers selling milk in that order. Approximately five of those handlers are located in Texas.

The Texas Panhandle Order covers processors selling fluid products in the Texas Panhandle. Approximately 45 dairymen ship an average of 10,700 pounds of milk per farm daily to two handlers covered by the order.

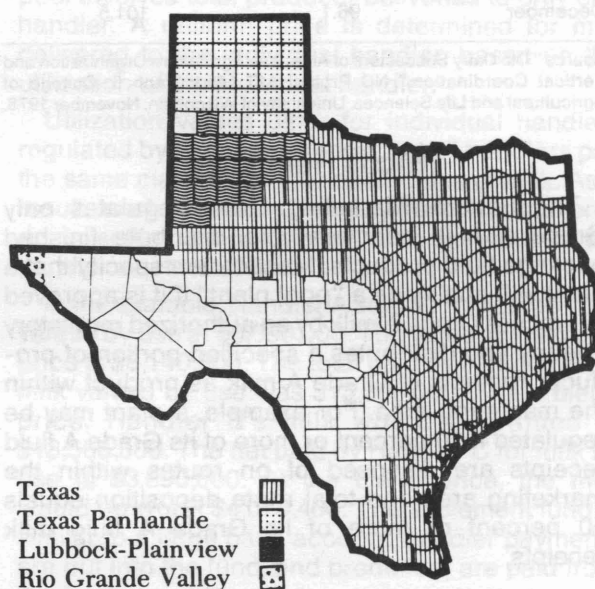
The Lubbock-Plainview Order includes two processors handling an average daily shipment per farm of about 18,000 pounds from 50 producers.

#### 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 qualified dairymen to share in the total producer pool by receiving an average price, adjusted for processor location and producer's milk fat test. The producer's pool is the total adjusted value of producer milk purchased by processors selling in a market.

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Figure 1. Federal marketing orders in Texas.



#### Objectives of Federal Milk Marketing Orders

Generally, federal orders have three major objectives:

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. Fluid milk sales usually are high in the fall and winter but decline during the early spring and summer (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. Orders are used to assure consumers of an adequate supply of milk throughout the year, by creating price stability for dairymen and supply stability for handlers.

**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 Percent	Index of In-Area Sales in Percent
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.

### Who is Regulated?

The Federal Marketing Order regulates only Grade A milk handlers who distribute finished package fluid products. Most orders specify that a plant will qualify as a "pool plant" if it is approved to process Grade A milk by an authorized regulatory agency and distributes a specified portion of producer receipts of Grade A milk as product within the marketing area. For example, a plant may be regulated if 10 percent or more of its Grade A fluid receipts are disposed of on routes within the marketing area and total route deposition equals 50 percent or more of its Grade A fluid milk receipts.

### Establishing an Order

The basis for establishing orders and the legislation defining the authority of 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. However, any interested party can initiate an order. The interested party 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 assign a Class I price to milk utilized as fluid milk, a Class II price to fluid cream and Grade A milk used to manufacture other food products, such as cottage cheese, frozen desserts and baby formula. A Class III price is assigned to milk used to manufacture cheese, butter and milk powder.

Currently (1987), 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, adjusted to 3.5 percent butterfat basis, for the month 2 months prior to the time for which the Class I price is being calculated, plus \$3.28. For example, the Minnesota-Wisconsin (M-W) price in October 1986 was \$11.69 so the Class I price in December 1986 was \$14.97. The "\$3.28" is called the Class I differential (see below).

Class II prices are tied to changes in the prices of butter, non-fat dry milk powder and cheese, just as Class III prices are based on the prices of these products. A tentative Class II price is set, based on the (M-W) price 2 months prior and adjusted for the changes in the prices of butter, non-fat dry milk powder and cheese. The tentative price becomes the Class II price for a given month as long as it is above the M-W for that same month. If the tentative price is below the M-W price for that month, then the M-W price becomes the Class II price. The Class III price for any month is equal to the M-W price for such month.

### The Class I Differential

The Class I differential generally is set at the time the order is promulgated. However, the 1985 Food Security Act increased the Class I differential in Texas from \$2.32 to \$3.28. This differential is supposed to reflect the added cost of producing Grade A milk and the cost of moving Grade A milk from Eau Claire, Wisconsin, to the Texas order.

### 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 published for milk at 3.5 percent butterfat, and is determined as follows:

Assume there are only three milk handlers being regulated in the market. Assume that the Class I price is \$15.00 per hundredweight, the Class II price is \$12.00 per hundredweight, and the Class III price is \$11.90 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 pounds at \$15.00/cwt.	+ \$4,500,000
Class II	20 million pounds at \$12.00/cwt.	+ \$2,400,000
Class III	10 million pounds at \$11.90/cwt.	+ \$1,190,000
<b>TOTAL</b>	60 million pounds	\$8,090,000

#### Handler B:

Class I	60 million pounds at \$15.00/cwt.	+ \$9,000,000
Class II	40 million pounds at \$12.00/cwt.	+ \$4,800,000
<b>TOTAL</b>	100 million pounds	\$13,800,000

#### Handler C:

Class I	10 million pounds at \$15.00/cwt.	+ \$1,500,000
Class II	10 million pounds at \$12.00/cwt.	+ \$1,200,000
Class III	10 million pounds at \$11.90/cwt.	+ \$1,190,000
<b>TOTAL</b>	30 million pounds	\$3,890,000

**Total pounds used by all three handlers** 190 million pounds

**Total value of the milk** \$25,780,000

The average price or minimum blend price for the milk:  $\frac{25,780,000}{1,900,000/\text{cwt.}} = \$13.568/\text{cwt.}$

The price paid by handlers for milk is adjusted up or down to reflect the butterfat test of the milk received by the handler.

## Pooling and the Producer Settlement Fund

The total value of the milk delivered to regulated handlers by producers is called the pool. All monies paid by handlers to the market administrators are paid into the settlement fund. The Texas Market Administrator collects the money paid by regulated handlers for producer milk. In the other three orders in Texas, handlers pay producers and co-ops directly and the balance of value by use is paid into or taken from the producer settlement fund.

Two types of market pools are used, the market-wide pool and the individual handler pool. In each of the orders covering Texas, a market-wide pool is used. In the market-wide pool, all of the producers who deliver milk to order plants are paid the uniform blend price pool. The individual handler pool involves total producer deliveries to only one handler. A uniform price is determined for milk delivered to the individual handler, based on the utilization of the individual handler.

Utilization values differ for individual handlers regulated by the same market, but all handlers pay the same class prices for each class of milk. As a result, each handler's net payment into the producer settlement fund is equal to the value of the handler's actual utilization.

In the example, Handler A sold 60 million pounds valued by use at \$8,090,000. The value at the blend price is \$8,140,800. The total paid by Handler B for milk valued by use was \$13,800,000. At the blend price, Handler B's milk would be valued at \$13,568,000. The net paid by Handler C for milk by use is \$3,890,000. At the blend price, the milk would be worth \$4,070,400. The settlement fund is similar to a large bank account, handler payments are put into the fund, and producers are paid from the fund at a uniform rate.

## The Butterfat Differential

The minimum blend price applies to milk testing 3.5 percent butterfat. Handlers pay dairy farmers on the basis of actual butterfat test. The blend price is adjusted up or down depending on level of butterfat in such milk compared to 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 0.115. If the monthly average Chicago butter price is \$1.45 per pound, the differential is \$0.167. Should a dairy farmer deliver milk testing 3.7 percent butterfat to the plant, then 33.4 cents is added to his blend price  $[(3.7 \times 10) - (3.5 \times 10) \times 0.162]$ . In the above example, the blend price is \$13.902/cwt. The farmer would receive \$13.735/cwt. for his milk.

## 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 on where the first receiving plant is located. The differential is added to the price for all the milk delivered by a milk producer, but added only to the Class I milk price 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, \$0.54 is the Zone 8 price differential.

If the uniform price is \$13.57 as quoted in the central market, producers delivering to a Houston processor would receive \$14.11 for milk (\$13.57 + \$0.54).

For calculating the value by utilization, the Houston plant would value Class I milk at \$15.54 (\$15.00 + \$0.54) if the Dallas Class I price is \$15.00. Class II and Class III prices for the Houston plant are the same as for the Dallas plant.

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 almost the same as when zones are used.

## Seasonal Pricing Plans

Some marketing orders (none of those in Texas) have provisions for the order allowing for the implementation of base plans. One such plan is the Class I base plan to encourage producers to tailor their milk deliveries more to the Class I need 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 lower 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 lower price for milk deliveries over base.

The third plan is called 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 season according to their deliveries.

## Changing or Terminating Federal Orders

Short-term 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.

Congress also can make changes from time to time. In 1985, Congress legislated Class I differential changes using the Food Security Act. Changes involving revisions in the Agricultural Marketing Agreement Act also require congressional action. These types of changes are subject to hearings in the orders.

Proposals to change an order usually involve industry-wide input and support; and are evaluated as to impact on producers, milk handlers and consumer groups. Many times hearings are held to collect information for and against proposed changes. The hearing process allows USDA or Congress information to aid the decision process.

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 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 (more than one-half the milk) vote in favor of termination.

## Other Information Sources

"The Federal Milk Marketing Order Program." Marketing Bulletin No. 27, Agricultural Marketing Service, USDA, June 1981.

Agricultural Marketing Service, USDA. "Texas Federal Order Number 1126," January 1, 1987.

Federal Milk Marketing Order 126, Market Administrator's Office, 1404 Carroll, Carrollton, Texas 75006,

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