ACTION SUMMARY SHEET FOR CONNECTICUT

Toward Reform of Fluid Milk Pricing in Southern New England: Analysis of Proposed State Level Milk Regulation Policies in Connecticut and Massachusetts

by

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February 12, 2007

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- The report that this sheet summarizes analyzes a proposed fee that will be collected on fluid milk sold by retailers and the proposed subsidy program that will establish a green price for dairy farmers. The green price is to be set by the proposed Connecticut Milk Commission at a level to sustain dairy farmers in CT. The green price reflects the added cost of production of milk and the added value that is not paid to farmers by the current milk channel. The added value includes the value of open space preservation, environmental stewardship, cultural diversity, tourism, and preservation of New England history.

- We also analyze the proposed retail threshold pricing policy. The CT Milk Commission, if it so decides after industry wide hearings, can set this policy to limit the transmission of any fee to consumers. Following New York's use of a similar policy since 1991, the CT Milk Commission could limit retail margins and lower retail milk prices.

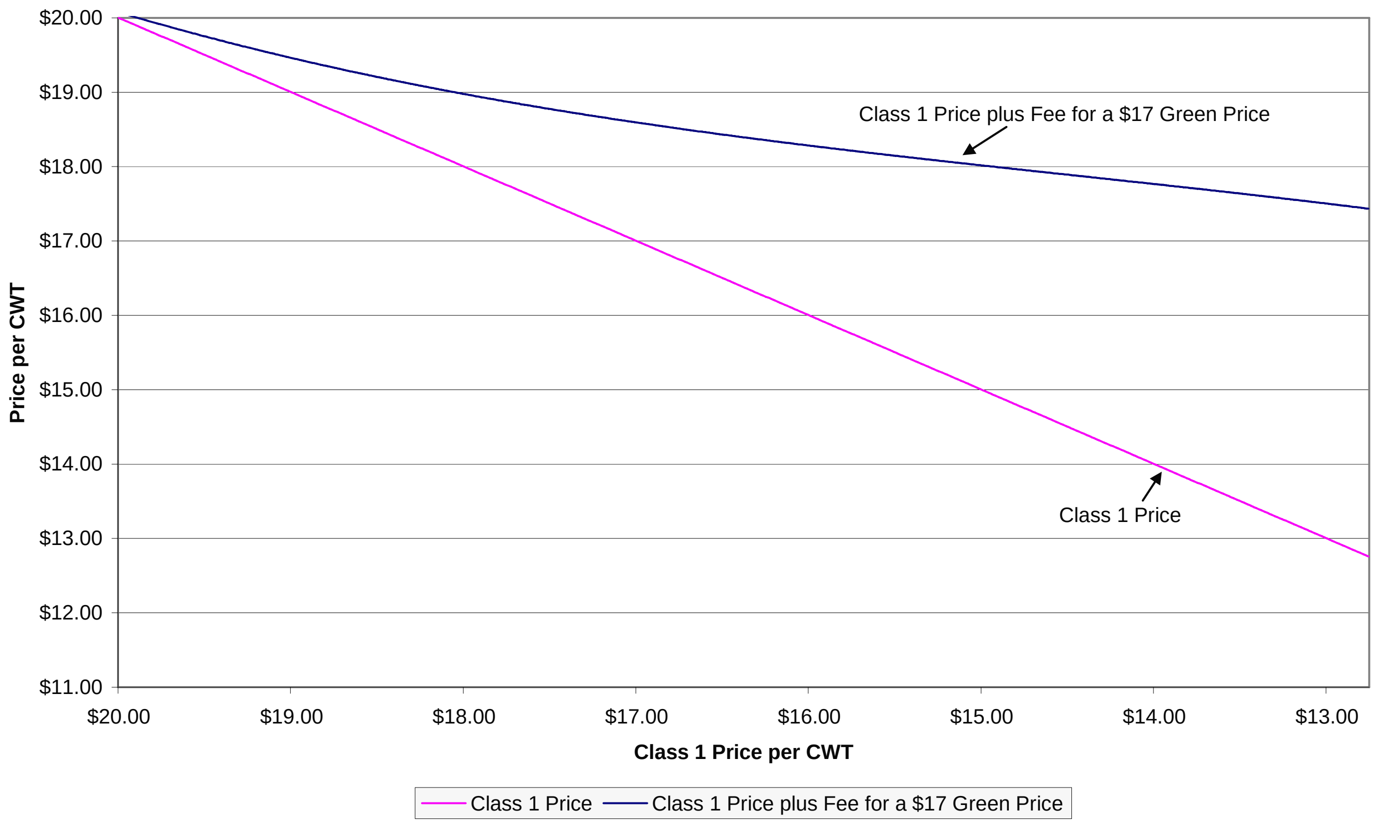
- We present a method to set the fee rate that is based upon readily available data, most notably the announced Class 1 price, the recent fee rate, and the desired level of green price. Statistical analysis of data from 2001 through 2006 gives us the parameters to set future fee rates.

- The Connecticut Milk Regulation Board decided to recommend a $17 green price, pending receipt of 2006 First Pioneer cost of production data for Connecticut. That level is used in this summary sheet, however, the report analyzes four different levels of support for Connecticut and Massachusetts farmers: $18, $17, $16, and $15.

- The required fee rate schedule for a $17 green price is graphically displayed on the inside page.

- The required fee rates per gallon or per hundredweight vary over time as the blend price (the farm price) of raw milk and the fluid (Class 1) price of raw milk vary. In low price periods one must collect a higher fee to maintain a given green price for farmers. However, in all cases the Class 1 (fluid) pay price plus the collected fees, i.e. the effective price paid by retailers for raw milk, declines as the Class 1 price declines. The fee policy retains only part of the raw milk price drop for farmers.

Figure 6. Dollars per CWT Based Milk Fee Schedule Necessary to Elevate the Blend Price to $17.00/cwt. in Connecticut, Fee Levied Only on Retail Fluid Milk



- We simulate the effect of the proposed fee and green price program over the 2001-2006 period to see how it works. Past performance is no guarantee of future performance; however, this five year period has two price cycle bottoms and an intervening high period. Thus the estimated dollar revenues may be overstated because of this 2:1 emphasis on the low part of the price cycle. On the other hand, low prices tend to persist longer in this industry than high prices.

- Over the 2001-2006 period the Class 1 price was above $18.50 per hundredweight in only seven months. For 47% of the months it was below $15.50. Thus if past is prologue at a $17 green price, it appears that a fee will be levied at all times. How often also depends on the height of the selected green price. At lower green prices fees will be lower and may not be levied at all times.

- Turning to the need for a green price, we have presented data on the blend price (raw milk pay price) to farmers at Hartford, CT. The blend price was above $17 per hundredweight in only four of the 63 months. The blend price was below $15, 61.9% of the time and below $12, 9.5% of the time. Therefore, a $17 green price is a very major improvement in farm level prices.

- At the other end of our alternatives, a $15 green price would raise farm prices 61.9% of the time.

- During the 2002-2006 period, if the $17 green price had been in effect, the state of Connecticut would have collected an average annual revenue of $11.5 million for pay out to farmers. Due to the milk price cycle the amount collected ranges from $5.7 million in 2005 to $16.7 million in 2002. Note that the green price payments as a percent of the value of raw milk sold by farmers ranges from 6% to 29%. They would have averaged 20% over the 2002-2006 period. Is this too much to pay for creating a sustainable dairy farming sector in the Connecticut economy?

Table 4. Annual Revenue from Regression Based Fee and Payments to Farmers: $17.00/cwt Green Price to Farmers: Connecticut, Fee Collected on Milk Sold at Retail

Year	Average Monthly Revenue per Gallon	Total Annual Revenue	Average Monthly Payments per CWT	Total Annual Payments	Surplus/Deficit	Farm Milk Value (Mil. Dollars)	Support as a % of Farm Milk Value
2002	$0.308	$16,072,616	$4.46	$17,136,000	-$1,063,384	$59.004	29.04%
2003	$0.302	$15,780,566	$4.11	$15,788,800	-$8,234	$53.259	29.65%
2004	$0.129	$6,720,457	$1.12	$4,281,600	$2,438,857	$67.124	6.38%
2005	$0.109	$5,720,218	$1.46	$5,603,200	$117,018	$59.867	9.36%
2006	$0.250	$13,081,323	$3.57	$13,721,600	-$640,277	$51.710	26.54%
Average Annual	$0.220	$11,475,036	$2.94	$11,306,240	$168,796	$58.193	20.19%

Notes: Figures are based on a constant annual production of 384 million pounds and a constant annual consumption of 599.1 million pounds, of which 75% (449.3 million pounds) are sold at retail. Farm Values are from Table 9.

- Another way to analyze the program's impact is to identify the fee per gallon collected from the retailers. In Table 7 for the $17 green price option, the annual fee per gallon is 31 cents in 2002, 30 cents in 2003, 13 cents in 2004, 11 cents in 2005, and 25 cents in 2006.

Table 7. Comparing the Fees per Gallon to Retail Margins and Excess Margins: Connecticut, Fee Collected on Milk Sold at Retail

Year	Average Monthly Revenue per Gallon based on $17 target	Retail Price[1]	Retail Margin[1]	Competitive Margin[2]	Excess Margin
2002	$0.308	-	-	-	-
2003	$0.302	$3.08	$1.447	$0.500	$0.947
2004	$0.129	$3.79	$1.510	$0.530	$0.980
2005	$0.109	$3.54	$1.607	$0.562	$1.045
2006	$0.250	$3.58	$1.580	$0.596	$0.984

1. Retail Price and Margins are based on All Milk in Southern New England Supermarkets from FMPC milk price surveys in June 2003, May 2004, July 2005, and November 2006.
2. Competitive Margins are adjusted 6% per year from 2003 estimate.

- One can compare this fee per gallon to the retailers' excess windfall profits in each year. They are 95 cents per gallon in 2003, 98 cents in 2004, $1.05 in 2005 and 98 cents in 2006. Therefore, the amount redistributed to farmers is a very small portion of retail excess windfall profits.

- A retail threshold price law, modeled after the New York price gouge law, can assure that the fee is not passed on to consumers.

- A threshold price law would also give the Connecticut Milk Commission and the Massachusetts Commissioner of Agriculture the ability to eliminate even more of the excess or windfall profits and lower retail milk prices to consumers, as has been done in New York.

- Flat milk pricing is a serious problem. Many but not all supermarkets charge the same price for whole, 2%, 1%, and skim milk. In a competitive market lower cost fluid milk, i.e. milk with less butterfat, would have lower prices. Flat milk pricing is a direct indicator that supermarkets have and use pricing power. Stop & Shop, for example, flat milk prices in 31 of its 34 stores. The three where it does not are the three stores that have a Wal-Mart nearby.

- A retail threshold price policy can be instituted by type of milk to eliminate flat milk pricing. Milk that has less butterfat would then be lower priced. Consumers would have an economic incentive to switch to the healthier products.

- For Connecticut we conclude that supermarket retail margins are so wide due to their pricing power that the proposed polices–the fee, the payment to farmers, and the retail threshold price policies–can support the farm price at $17 per hundredweight, with little or no impact on consumers, and only a marginal reduction in average retail margins. Alternatively, the proposed Connecticut Milk Commission could use the retail threshold price policy to lower retail prices as well as support farmers while paring retailers' excessive windfall profits.

- Farmers Cow brand milk is a niche marketing strategy launched in 2005 by six eastern Connecticut farmers. Farmers Cow milk is sold only as half gallons. At $2.87 per half gallon, it was the highest priced half gallon milk that we surveyed. Hood, the next highest averaged $2.61, and private label half gallons are available at $2.28 per half gallon or less.

- The distinctive difference is that Farmers Cow is produced by these six farmers. Other brands of milk are also fresh milk, BST free, or produced in Connecticut.

- Even if it proves successful for its six owners, the Farmers Cow high priced niche strategy is not a viable option for the other 163 farmers in CT. CT milk production equals 85% or retail fluid sales. This much milk can not be sold in half gallons at $2.87 each.

Visit the Food Marketing Policy Center web site at http://www.fmpc.uconn.edu/research/milk/ to find out more about our research on milk prices and to read the underlying base papers:

Toward Reform of Fluid Milk Pricing in Southern New England: Farm Level, Whole-sale and Retail Prices in the Fluid Milk Marketing Channel: 2003 – 2006

and

Toward Reform of Fluid Milk Pricing in Southern New England:
Milk Market Channel Policies for Connecticut and Other States

Also on the web site are related newspaper articles, related fact sheets, papers by others, and proposed bills in New England state houses to reform milk prices.