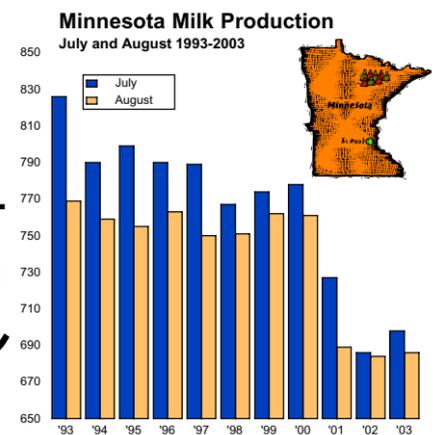


# CHEESE REPORTER

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## Controversy Over Level Of Farm Versus Retail Milk Prices Continues

**Storrs, CT**—The controversy in New England continues over whether retail milk prices are too high compared to farm milk prices, and over possible legislative remedies to those price differences.

The University of Connecticut's Food Marketing Policy Center this week released a study that concludes that retail milk prices in New England are "much higher" than in New York, which has a milk price gouging law that establishes a maximum threshold retail milk price of 200 percent over the announced Class I milk price plus any over-order premiums paid to farmers.

But a report prepared for the Massachusetts Food Association contends that the UConn price analysis is "flawed," that retail milk price markups are "reasonable," and that proposed legislation in Connecticut and Massachusetts is "misguided" and "grossly interferes" with the marketing of fluid milk.

The new UConn study was written by Adam N. Rabinowitz, graduate research assistant, Matthew Schwane, undergraduate research assistant, and Ronald W. Cotterill, director, all with the Food Marketing

Policy Center. The study reports results for a retail milk price survey that was conducted in June 2003.

The survey found that, in nearly all cases, retail fluid milk prices in New York are lower than prices in New England for each type and channel, and the change over time is also different. For example, 2 percent milk in New York chain stores was \$2.25, down 10 cents from a survey conducted last November, while the same milk in New England was \$2.90, up five cents from last November.

Prices at convenience stores and chain supermarkets "are quite close," the survey found, while prices at club and limited-assortment stores "are much lower" In fact, club stores and limited-assortment stores were found to have "significantly cheaper milk prices in all geographic areas in this study."

One "significant change" from last November, the study noted, is that chain store prices in New York dropped about 10 cents across all types of milk, while there was no respective change in New England chain stores. The drop in New York prices was "due to the decrease in the

price threshold under the New York state price gouging law."

Last November, UConn had noted that Wal-Mart Supercenters were not the lowest priced chain in New England, "despite its reputation as a low-price leader in retail. This is no longer the case." The June survey found that Wal-Mart has come down in price in New England, and is the lowest priced chain in New York.

"It appears that Wal-Mart has listened to the press on high milk prices and has responded, reduced the gap between wholesale and retail prices, and now along with DeMoulas, prices milk in an effectively competitive fashion," the study said.

In addition to duplicating its November survey in New York, UConn researchers also cooperated with the New York State Attorney general's office to collect data from 191 stores throughout the state. The survey found that convenience stores in New York sell the highest-priced milk in the state, ranging from an average lowest price of

• See **Retail vs. Farm Price**, p. 15

### MIF Opposes Hearing On Fluid Milk Definition, Wants Greater Knowledge Base On Milk-Based Drinks

**Washington**—Members of the Milk Industry Foundation (MIF) are opposing a recent request that the US Department of Agriculture (USDA) hold an emergency hearing to address the fluid milk product definition under federal milk marketing orders.

In comments filed with USDA last Friday, MIF also suggested that USDA delay action on this subject "to allow the industry to develop a greater knowledge base about new milk-based drinks and other beverages containing milk, and to understand the competitive relationship between traditional fluid milk products and those that contain smaller amounts of milk-derived components."

More specifically, MIF suggested a delay of one year "to allow adequate market experience to evaluate the competitive beverage market and to

• See **Fluid Milk Definition**, p. 6

### Domestic Commercial Sales Of Nonfat Dry Milk Hit 10-Year Low, As Does Dairy Use

**Elmhurst, IL**—Domestic commercial sales of nonfat dry milk (NDM) last year totaled 741.7 million pounds, down 19.4 percent, or 178.5 million pounds, from 2001 and the lowest level of domestic commercial NDM sales since 1993, according to a new report from the American Dairy Products Institute (ADPI).

Domestic commercial NDM sales were last below the 800-million-pound mark in 1993, when they totaled 591.0 million pounds. The highest level of domestic commercial NDM sales since then was 954.7 million pounds in 1995, while the highest level this decade was 920.2 million pounds in 2001, according to ADPI's "2002 Dry Milk Products Utilization & Production Trends," as well as previous ADPI reports.

This compilation represents the 55th annual industry-wide survey of end-uses. The census, participated in by ADPI members, other cooperating processors, and distributors, reflects approximately 85 percent of

total domestic distribution. With such comprehensive coverage, projections have been made from the survey data to the total industry.

The dairy industry is by far the largest domestic buyer of nonfat dry milk, and last year NDM sales to the dairy industry totaled 416.2 million pounds, down 33.0 percent, or 204.9 million pounds, from 2001. That was also the lowest level since 1993, when sales to the dairy industry totaled 378.2 million pounds.

Nonfat dry milk sales to the dairy industry had reached a high of 651.3 million pounds in 1998.

NDM sales to the dairy industry accounted for 56.1 percent of total domestic commercial sales of NDM last year, down from 67.5 percent of total domestic commercial sales in 2001. Prior to last year and going back to 1993, the dairy industry's share of total domestic commercial sales of NDM has ranged between

• See **NDM Sales Decline**, p. 8

### Use of rbST Found To Boost Output Per Cow, But Not Net Income Per Cow

**Ithaca, NY**—The use of recombinant bovine somatotropin (rbST) on New York dairy farms increased milk production per cow but did not translate into any increase in net income per cow, according to a new paper by Loren Tauer, professor in Cornell University's department of applied economics and management.

RbST, also known as bovine growth hormone (BGH), became commercially available to US dairy producers in February of 1994, following years of investigation and testing in the US, Tauer noted. RbST can be injected into the dairy cow to augment her naturally produced levels of this hormone, enhancing milk production, but also requiring additional feed and other inputs to achieve increased milk production.

Given the large production response per cow that most of the tests reported prior to rbST approval, the hormone was generally projected to be profitable for dairy farmers, with estimates often exceeding \$100 per year per cow, although some projected little or no profit, Tauer noted.

Although Monsanto's Posilac rbST product has been available for almost 10 years and a number of studies have estimated the determinants of rbST adoption, few studies have assessed actual profitability on dairy farms, he explained.

Tauer and W. A. Knoblauch used data from the same 259 New York dairy producers in 1993 and 1994 to estimate the impact of rbST on milk production per cow and return above variable cost per cow. The use of rbST had a positive and statistically significant impact on the change in average production per cow between the two years, but the profit change affect, although positive and large, was not statistically different from zero.

This new paper revisits the New York dairy farms for the production

• See **RbST Income Impact**, p. 20

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## Retail vs. Farm Price

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\$2.35 for 1 percent milk to \$2.67 for whole milk.

On the other hand, the survey found that wholesale clubs sell the least expensive milk, with averages always at or below \$1.97. The average lowest price for whole milk at chain stores was \$2.29, 51 cents cheaper than in New England.

"Even if one considers the average price of milk at chain stores at \$2.36, this is still significantly cheaper than the New England chain store average price, \$3.16 per gallon," the study noted.

Regarding compliance with New York's price threshold, the UConn analysis indicated that when the threshold price decreases substantially, as was the case from November to June, "compliance decreases as well."

UConn researchers also assisted Deborah Robinson, an intern with WashPIRG, in surveying Seattle area supermarkets and convenience stores in June 2003. The survey found that milk prices are higher in the Seattle area than in New England.

"Retail milk pricing is very non-competitive in Seattle and the big chains lead the way," the study said. The "fringe competitors" use milk as a loss leader to attract business, but "so few consumers actually switch that the high milk prices remain profitable for the leading chains."

### Consumers, Farmers Losing Out

"Lack of competition is driving retail milk prices in New England to record levels, despite some of the lowest farm prices in years," the UConn study said. "The impact of this is extensive, and is felt by both farmers and consumers."

Using a documented cost of 58.2 cents per gallon of milk for processing and delivering milk to retail outlets in April 2003, UConn researchers estimated that the wholesale price for milk delivered to the store in June, with a \$1.11 Class I price, was \$1.69 per gallon. Retail prices in New England continue to hover above \$3.00 per gallon.

"Clearly, it does not cost supermarkets \$1.31 a gallon for in-store handling, storing, and selling of milk," the study said. "It is clear that consumers lost out on the low farm prices from December 2001 to September 2003, while dairy farmers continued to suffer dire economic times."

While it appears that the New York price gouging law is effective in helping keep milk prices low, "there are obviously other forces in New York that play a factor because many firms' low prices are well below the law's threshold," the study said. Further, the increased lack of compliance with New York's law at low farm milk prices "indicates that a more complex law may be necessary if and when New England states

attempt to control the unconscionably excessive pricing of fluid milk."

The bottom line is that it appears the New York law, however imperfect in concept and/or enforcement, "is working in at least one fundamental and important economic dimension. Retail milk prices in New York are closer to the cost of production and distribution than they are in New England when farm prices are low.

"The law seems to be making a major contribution to the allocative efficiency in the New York milk industry," the study continued. "However, it has done little to elevate farm prices, thereby not addressing the dairy farm crisis that the region faces."

### Milk Prices Are Not A Problem

The report prepared for the Massachusetts Food Association was written by agricultural economist. John Schnittker. The specifics of the report address the Connecticut and Massachusetts milk pricing proposals.

There are "significant differences" between the two proposals, the report noted. The Connecticut proposal limits wholesale and retail markups to 140 percent and 130 percent, respectively, while the Massachusetts proposal calls for a finding of "unconscionably excessive" pricing and possible legal action by the state if the retail price equals or exceeds 200 percent of the farm price.

But from a practical standpoint, the two proposals are "very similar," the report said, as "they attempt to artificially create a situation in which the processor or retailer cannot cover the cost of acquiring, processing, transporting and merchandising fluid milk. Processors and retailers are then placed in the untenable situation of either not covering their costs and losing money or increasing the price paid for fluid milk in an attempt to widen the allowable farm-retail spread."

The analysis and findings of Schnittker's report regarding the Connecticut proposed law apply directly to the Massachusetts proposal. The overall costs of producing, processing, and merchandising fluid milk would increase, and consumers would be at risk that grocery store milk prices would increase.

"There is little doubt under either proposal that the low-priced, discount milk now available at many non-grocery store locations would see significant price increases, eliminating the discount milk option now available to low-income consumers," the report said.

At face value, retail prices that equal or exceed 200 percent of the farm price "sound excessive and unjustified," the report stated. "But this approach to milk pricing is mistaken and simplistic as well as arbitrary and capricious.

"It omits any recognition of the cost involved in processing, trans-

porting and merchandising fluid milk in its journey from the farm to the grocery store," the report said. "It also ignores the fact that processors pay a premium over and above the Class I price for fluid milk and that dairy farmers also receive government payments to compensate them for the presently low fluid milk price."

For example, if the farm price for fluid milk is \$1.20 per gallon and processors pay an over-order premium of 12 cents per gallon, the cost to the processor is \$1.32 per gallon. Processor costs, which include the cost of the container, processing, and transportation to the retail store are conservatively around 85 cents a gallon, resulting in a delivered wholesale price of \$2.17 per gallon.

Merchandising costs at retail for a grocery store, which include labor, utilities, capital cost, as well as advertising and other costs are at least 45 cents per gallon, giving a conservative estimate of \$2.62 per gallon before overhead and profit are added on.

The Massachusetts law as written "would make it impossible for a retail grocery to cover store milk cost at current farm price levels, as the maximum price allowable before the threat of a finding of 'unconscionably excessive' is only \$2.40/gallon in our example while the grocery store costs are \$2.62/gallon," the report said.

As with the Connecticut proposal

there is an incentive to increase the price paid to the producer so that the farm-retail spread widens to allow processors and retailers to cover their cost, the report continued. The Massachusetts proposal "clearly places even more pressure than the Connecticut proposal on the retailer to increase his pay price so that he is able to cover the wholesale price, store merchandising cost and still allow for overhead and profit."

According to the report, if this legislation were enacted and retailers increased their price to processors with the understanding that the increase would be passed along to dairy farmers, "the effect would be to increase the total costs associated with producing, processing and retailing fluid milk.

This would be a threat to consumers as it would likely sharply increase the price of fluid milk now marketed at discount prices" at various outlets.

"Chain grocery stores would also be in the position to increase retail prices as long as they increased returns to producers, setting up the classic case of spiraling costs and reduced fluid milk consumption," the report added.

Given the "true cost" of producing, processing and merchandising fluid milk, the report said the proposal "is misguided and should be viewed as an uneconomic and inefficient method to deal with low milk prices at the farm level." •

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