

Cornell Conference for Dairy Economists and Policy Analysts

Salt Lake City May 10th 2012

Comments on Classified Pricing

By

Dr. Corey Freije

Agricultural Economist

Federal Order 30 Minneapolis, Minnesota

Andy's Questions

- Question 1—**Does it make sense to assign a higher price to fluid milk when the spread between fluid and manufacturing milk is narrowing and adjust only the higher fluid price to location?**
- Question 2—**Given falling per capita demand and increased competition in the market for fluid milk does it still make sense to treat the fluid market as the cash cow for dairy farmers?**
- Question 3—**If the Class I differential is eliminated, is there any role or justification for some kind of Federal Milk Marketing Order?**
- Question 4—**If the only regulated prices were Class I differentials, a premium all processors had to pay on Class I milk, what would be the likely market response and outcomes?**

Outline

- Origins of Classified Pricing
- Criteria for Procedure Evaluation 1973
- Procedure Options
- Evaluation Criteria 2009
- Prior Analysis 1988
- Anecdotal Evidence
- Conclusion

Origins

- Reference Literature
 - Herb Forest, conversation taken down by Joel Blum, 1985
 - Report of the Milk Pricing Advisory Committee, USDA, 1972
 - Federal Milk Marketing Orders An Analysis of Alternative Policies, H. McDowell, A. Fleming, and R. Fallert, ERS Agricultural Economic Report Number 598, 1988
 - Report on Alternative Pricing Options, AMS Dairy Programs, Alternative Pricing Options Committee, 2009
 - Federal Milk Order Study Committee(Nourse Report), USDA, December 1962.

Origins

- “Establishing a mechanism for making more orderly the changes which were taking place in the industry would be primary and main function of the order program and not just constantly increasing prices.”— Herb Forest 1985(pertaining to the earliest period of orders)
- “Classified price plans, i.e. the establishment of a schedule of prices which handlers pay for milk, differentiated according to end-product use by the handler may be traced back at least to 1903.”—Nourse Report 1962
- “Price classification was designed primarily to obtain higher returns for producers. ...there have been important examples of classified pricing without pooling”-- Leland Spencer, Nourse Report 1962.
- “So the Act was drafted in a period of time when the intent was to limit the authority of the Secretary to do certain things and not to leave him a lot of latitude to do anything else. One of the things that was specified was that the Secretary shall not regulate resale prices.”— Herb Forest 1985 (pertaining to the earliest period of orders)

Criteria for Procedure Evaluation

1973 Milk Pricing Advisory Committee

- Supply-Demand Balance (reduced need for a reserve for the fluid market)
- Stability—refers to orderly marketing but rejects complete rigidity ‘Pricing Policies must be **responsive** to changed economic relationships as they develop in the milk industry.’
- Income- low returns are due to national price and production instability due to cycles of production and technological change
- Coordination with Price Support Program- close coordination is essential...to avoid excess supplies going to commodity credit corporation.
- Data Availability and State of the Arts— for both economic formulas and the hearing process
- Understandable Pricing Concept—‘A value must be attached to simplicity, understandability, and intuitive appeal of an administered pricing system.’ —Knutson 1973

Procedure Options

1973 Milk Pricing Advisory Committee

Alternative Class I Pricing Procedures

- Economic Formulas
 - Economic Index Formula
 - Economic Equilibrium Formula
- Product Formulas
- Hearings

Evaluation Criteria 2009

Alternative Pricing Options Committee

- Sustainable—Tools and info used in the method should be available over a long period of time.
- Predictable—The method should allow for long-range planning and short-term market forecasting.
- Uniform—The method should be calculated and applied in a consistent manner.
- Transparent and Understandable—It should be possible for market participants to replicate the results of the method using tools and info available to the general public.
- Based on Sound Economics—The method should reflect the supply and demand conditions for milk used in manufacturing.

Prior Analysis 1988

- “...absent classified pricing and pooling...The role of Federal milk marketing orders in monitoring markets and providing market information could be retained or expanded. In doing so, competitiveness of markets could be assured, thereby reducing undue risk and uncertainty associated with excessive market power.”– H. McDowell, A. Fleming, and R. Fallert 1988 ERS #598

Anecdotal Evidence

Retail Price Equivalents				
milk	size	cost	per gallon	price per cwt
organic	half pint	\$2.10	\$33.60	\$389.09
National Brand	quart	\$1.00	\$4.00	\$46.32
store	gallon	\$3.39	\$3.39	\$39.26
almond milk	size	cost(pack of 8)	per gallon	
Blue Diamond/ Walmart	half gallon	\$41.37	\$10.34	\$119.77
cheese	size	cost		price per cwt
brillat savarin	1 pound	\$24.99		\$199.92
cheddar	1 pound	\$1.53		\$15.25
*source:	Walmart.com			

Conclusions

- The gap between class I and class III is functional
- Pooling differentials only is possible
- Federal orders without Classified Pricing and Pooling have been studied before
- The class I price is as low as it is to allow functioning of the Federal orders without adversely affecting the dairy industry

Towards Further Research

- Price discovery options
- Economic formulas becoming models(Computable General Equilibrium models)
- Macroeconomic econometric models
- Back to the criteria