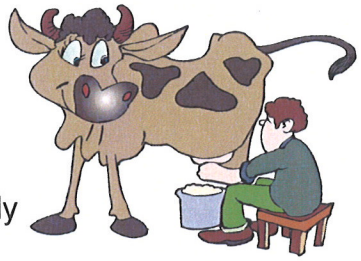
MARKETING SERVICE
BULLETIN

What is a Federal Milk Marketing Order, and ... What Does it Mean to Me ?

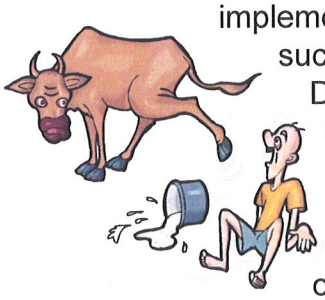
-- PART I --



Federal milk marketing orders have been an integral part of the U.S. dairy industry for many, many years. Milk orders were first implemented in the 1930's and have been a fixture ever since. They have been continually amended and updated, however, to accommodate industry modernization and changing marketing conditions. Despite this long-term presence, milk orders remain an unknown to most Americans. Moreover, misconceptions and misunderstanding of milk orders is not uncommon among consumers and even dairy industry participants. Although understanding the intricacies of their day-to-day operation does require a substantial degree of order-specific knowledge, the basic concepts and provisions of milk orders are easy to comprehend. This bulletin contains a brief description of the basics of Federal milk marketing orders. A future bulletin will explore the operation of milk order pricing and pooling in more detail. But first ...

A Little History. Milk orders originated in the 1930's, and were preceded by Federal regulations known as "marketing agreements". Marketing agreements, backed up by licenses for processors, were authorized in 1933 as part of the Agricultural Adjustment Act. Amendments to this act two years later provided the legal foundation for the Federal order system. The Agricultural Marketing Agreement Act of 1937 further amended the 1933 Act and is the enabling legislation under which milk orders continue to exist.

Dairy historians have characterized milk marketing conditions in the decades prior to Federal regulation as chaotic and disorderly. Burdensome surpluses, extreme price instability, and significant disparity in bargaining power between buyers and sellers were notable problems confronting the dairy industry in the early 1900's. During this period, organized producers implemented numerous classified pricing systems with varying degrees of success. All these pricing structures collapsed during the Great Depression, resulting in severe price and income declines. The subsequent chaotic marketing conditions were the impetus for the Federal regulations which authorized the milk order program.



The disorderly conditions confronting the dairy industry prior to order implementation were a result of market instability. Fluid milk markets are inherently unstable due to the uncoordinated nature of fresh milk supply

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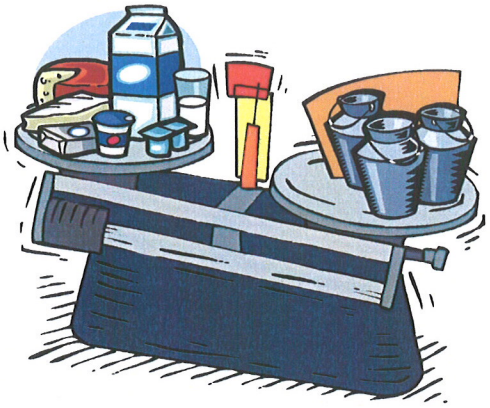
versus demand, which is compounded by milk's perishability. Biological realities cause milk production to vary seasonally and even day-to-day, but this production variability does not correspond with fluctuations in demand. Changes in demand often run counter to variations in milk supply. For example, fluid milk sales are typically at their lowest levels during the late spring through early summer months due to school closings and the vacation season. While fluid milk demand is declining, however, milk production is increasing due to the "spring flush". This situation reverses in the late summer and early fall when milk production seasonally declines. Simultaneously, dairy product demand increases due to the late summer resumption of school sessions. Since the seasonality of milk production does not match its demand counterpart, "surpluses" during the spring flush are necessary in order for the industry to have adequate production capacity to meet demand for fresh milk during the rest of the year. Because of its perishable nature, fluid milk cannot be stored during its production peaks to balance demand during its troughs.

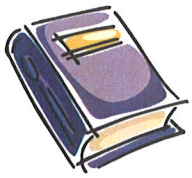


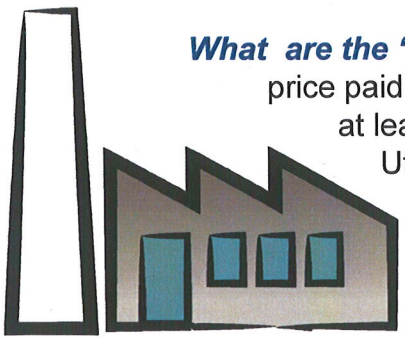
The incompatible nature of supply and demand combined with fluid milk's perishability are but one set of characteristics that contribute to the "unique" nature of this product. Milk's perishability necessitates specialized refrigeration equipment and strict sanitary requirements from the farm to the consumer. The extreme bulkiness of fluid milk, along with its perishable nature, requires transportation from farm to processor on a continual basis. Fresh milk is typically picked up at the farm every other day for small to medium sized producers, and every day for large dairy farms. Furthermore, milk is unique among all agricultural commodities in that it is "harvested" continually. Cows must be milked a minimum of two times a day, every day. This unique set of physical characteristics contribute to the inherent instability in the fluid milk market.

Federal milk orders were conceived and implemented with the goal of counteracting the inherent instability in fluid milk markets. The milk order program's primary objective is to provide a framework to make buying and selling milk a more orderly process for producers and processors. By promoting a more stable marketing environment, orders help assure an adequate supply of quality milk to meet current and anticipated consumer needs.

With this historical background in mind, lets examine the world of Federal milk marketing orders.

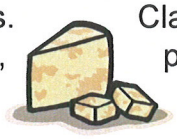
What is a Federal milk order? A Federal milk order is a regulation, issued by the Secretary of Agriculture, which places certain requirements on the first buyers of milk from dairy farmers within a specific geographic area. The first buyers of milk are typically referred to as *handlers*, while dairy farmers are called *producers*, and the regulated geographic territory is termed the *marketing area*. A milk order is not authorized unless two-thirds of the affected producers supplying the proposed marketing area approve its implementation. This approval is obtained via marketwide voting where each producer, regardless of marketing size, is afforded one vote.

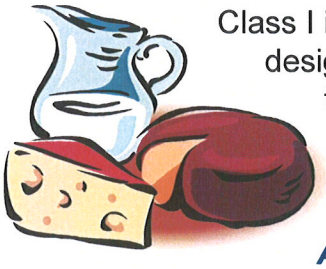




What are the "requirements" placed on handlers? The most important requirement is the price paid by handlers for milk purchased from producers. Handlers are required to pay at least minimum Federal order prices according to how the milk is utilized. Utilization is based on the finished dairy product in which the milk is used. "Classified Pricing" is the term typically used to describe this type of pricing system.

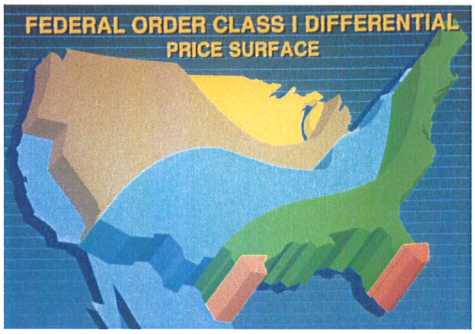
What is classified pricing, and how is it used by milk orders? Classified pricing, or classified-use pricing, is a system that assigns value based on the end use of the product. Milk orders employ a pricing system that categorizes each dairy product into one of four classes. The highest usage category is Class I, and this classification includes most bottled milk products. These "drinkable" products are typically referred to as fluid milk products. The Class II pricing category includes fluid cream and soft manufactured products, such as ice cream, yogurt and cottage cheese. These items are sometimes referred to as "spoonable" dairy products. Classes III and IV include the "hard" manufactured dairy products. Class III includes all hard cheeses, such as cheddar, mozzarella, swiss, provolone, etc., while butter and dried milk items are designated Class IV.





Class I items are the most perishable among all dairy products, and milk orders have been designed to attribute the highest value to this category. Class I products are assigned the highest price, followed in descending order by the manufactured product categories, Classes II, III, and IV. However, market product price conditions can cause this typical hierarchy of prices to vary.

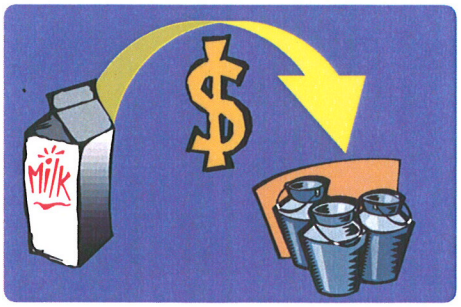
Are Class Prices the same in every milk order? Prices paid by handlers are identical in all orders for milk utilized in the manufactured product categories, and are based on wholesale market prices for butter, cheese, nonfat dry milk, and whey. The price for milk used in Class I varies by location, however, and each county in the continental U.S. is assigned a specific Class I price. As depicted by the accompanying map graphic, the level of Class I prices generally increases in broad geographical "bands" as milk moves further south.



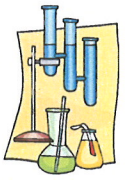
Class I prices are determined on a monthly basis by adding a fixed differential for each location to the higher of the Class III or IV price. Prices paid to producers reflect these differentials since they are adjusted for the location where the milk is first received.

How are producers paid under the milk order system? Federal milk order provisions require that producers are paid no less than the minimum prices specified by each respective order. Four milk orders require minimum payments based on two components of producer milk -- butterfat and skim. The remaining six orders employ a multiple component pricing system in which producers receive payment based on the pounds of protein, butterfat, and other solids marketed. These orders also specify a per hundredweight payment based on total milk pounds marketed. Four of the six multiple component markets also employ a quality adjustment based on the somatic cell count of the milk marketed. (The Central order employs a multiple component pricing system with somatic cell adjustment.) Minimum prices paid to producers are determined each month based on a process called *marketwide pooling*.

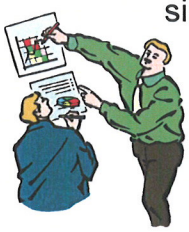
What is marketwide pooling? Under marketwide pooling, the total classified value of producer milk received by every handler regulated under a milk order is combined, or "pooled", each month. Proceeds from this pool are distributed to producers in a uniform manner depending on the pricing system employed under the order. The four milk orders that use skim and butterfat pricing compute a minimum Uniform Skim Price by combining skim milk values for all regulated handlers and dividing this amount by the total pounds of skim in the marketwide pool. The minimum Uniform Butterfat Price is computed in a similar manner for these markets.



In the six multiple component pricing orders, producers are paid the Class III value for protein, butterfat, and other solids on a per pound basis. In these multiple component orders, a uniform per hundredweight price is also paid to producers. The dollar amount remaining from the handlers' use value in the marketwide pool, after deducting component payments, is divided by the total pounds in the pool to determine the uniform per hundredweight payment. This payment is known as the Producer Price Differential (PPD), and it can be either positive or negative. The PPD's amount and sign is determined by the revenue surplus, or shortage, in the marketwide pool after producer protein, butterfat, and other solids payments have been deducted. Uniform prices and the PPD paid to each producer are adjusted to reflect the applicable Class I differential for the location where the milk is first received.



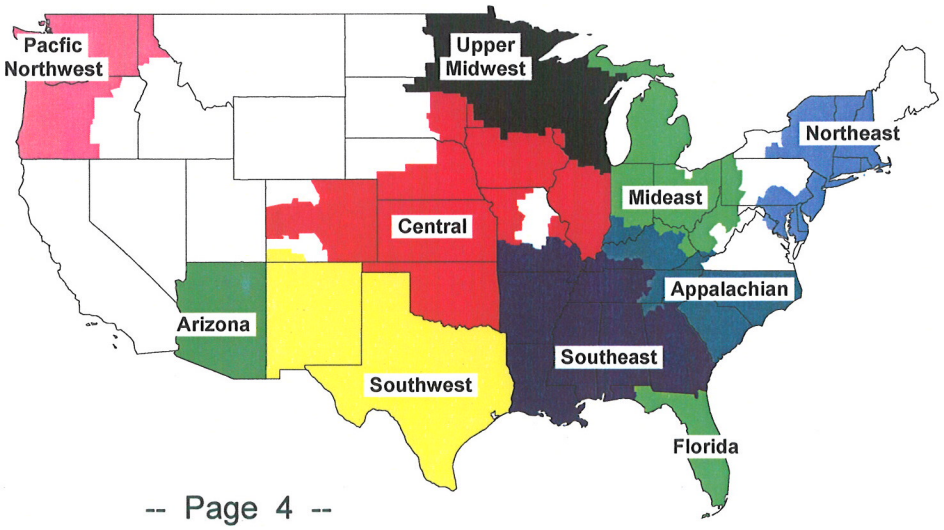
Are there other important features of milk orders? Some of the other important functions of the milk order program include the verification of weights and component tests, comprehensive auditing of handler records, enforcement of timely payments to producers, and providing appropriate market information. Conducting impartial audits helps to ensure accurate reporting by handlers, which is essential to the proper operation of a classified pricing system. Likewise, accurate verification of weights and component tests for producer milk is critical to equitable marketwide pooling and accurate payment to producers. Producers are assured of receiving timely payments for their milk marketings since payment dates are specified in each milk order, and are rigidly enforced by Market Administrators. Market information and analysis is important in decision making for industry participants and other interested parties. The dairy industry relies on the market information and statistics provided by the milk order program to make business decisions, as well as sound judgements pertaining to proposed changes in milk order provisions.



How are milk orders revised? Federal milk orders are implemented and revised through the use of the public hearing process. The hearing process is used to gather evidence prior to the issuance of an order and to amend an existing milk order. Dairy cooperatives, individual producers, handlers, and any other interested parties can participate in these Federal rule-making procedures.

Proposed changes to existing order provisions are either issued or denied upon completion of the hearing process. If revisions are issued, producers and their marketing agencies are given the choice of either adopting the order as amended, or terminating the Federal milk order. The amended order must achieve two-thirds approval in marketwide voting by individual producers, or their marketing representatives. This process guarantees that milk orders remain voluntary, and helps keep them relevant to ever-changing marketing conditions.

Federal Milk Marketing Orders



A FEDERAL ORDER DOES :

> Classify milk according to use.

> Establish minimum class and component prices monthly.

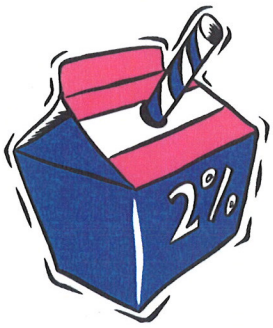
> Determine either a Producer Price Differential or a Uniform Price monthly.

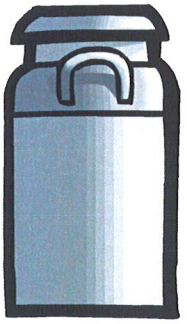
> Place certain requirements on the first buyers of milk from producers.

> Establish a "level playing field" for handlers, with identical class prices for all handlers similarly located.

> Provide important other functions:
- Impartial audits of handler records.
- Verify weights and tests.
- Enforce timely payments to producers.
- Provide market information.

A FEDERAL ORDER DOES NOT :





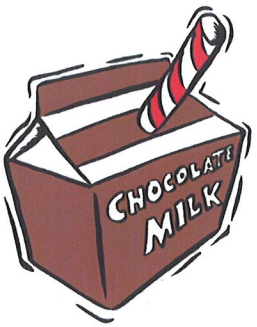
> Set wholesale or retail prices.

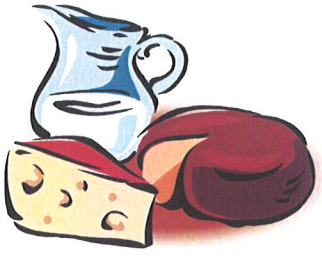
> Guarantee a fixed price level or subsidize producer payments.

> Establish maximum prices paid to producers.

> Regulate individual producers, nor guarantee a market for their milk.

> Establish or enforce sanitary or quality standards, nor establish any retail standards.





> Administer either the MILC or Price Support Program.

> Regulate:
- From whom a plant may buy milk.
- How much milk a plant can buy.
- How much milk a producer markets.
- To whom a producer sells milk.

	Statistical Uniform Price		Producer Price Differential		Class I Utilization	
	May '09	Apr '09	May '09	Apr '09	May '09	Apr '09
Northeast	12.18	12.08	2.34	1.30	39.91	41.74
Appalachian	13.28	12.97	-----	-----	64.70	68.05
Florida	15.65	15.11	-----	-----	85.68	85.79
Southeast	13.21	13.14	-----	-----	57.18	61.02
Upper Midwest	10.30	10.98	0.46	0.20	12.43	13.29
Central	**10.82**	**10.91**	**0.98**	**0.13**	**26.78**	**31.56**
Mideast	11.27	11.28	1.43	0.50	37.74	39.56
Pacific Northwest	10.83	11.01	0.99	0.23	26.18	33.08
Southwest	11.84	11.89	2.00	1.11	32.56	34.94
Arizona	11.15	11.06	-----	-----	30.68	32.28

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