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Time is Right for Multiple Component Pricing in Southeast

When federal orders were put in place during the Great Depression, the primary goal was to ensure a consistent supply of fluid milk for higher population urban areas, which is why Class I is typically the highest-priced use of milk. But as per capita fluid consumption dropped and cheese consumption jumped—not to mention the growth in exports and milk powder ingredients—manufacturing is now the most common use of producer milk.

Higher components result in greater product yields and improved manufacturing plant efficiency, thus Multiple Component Pricing (MCP)—paying producers for pounds of butterfat, true protein, and other solids in milk—made sense in orders with high manufacturing utilization. The major federal order reform implemented January 1, 2000 created eleven consolidated Federal Milk Marketing Orders. The Western order was voted out by area producers in 2004, leaving the current ten. Six orders (Northeast, Upper Midwest, Mideast, Central, Southwest, and Pacific Northwest) pay producers for their milk on an MCP basis.

Fat-skim pricing is used for producer payments in the other orders: Southeast, Appalachian, Florida, and Arizona. Fat-skim pricing pays producers for pounds of butterfat, then lumps the remaining milk components into skim volume. Under fat-skim pricing, a pound of water is worth the same as a pound of protein.

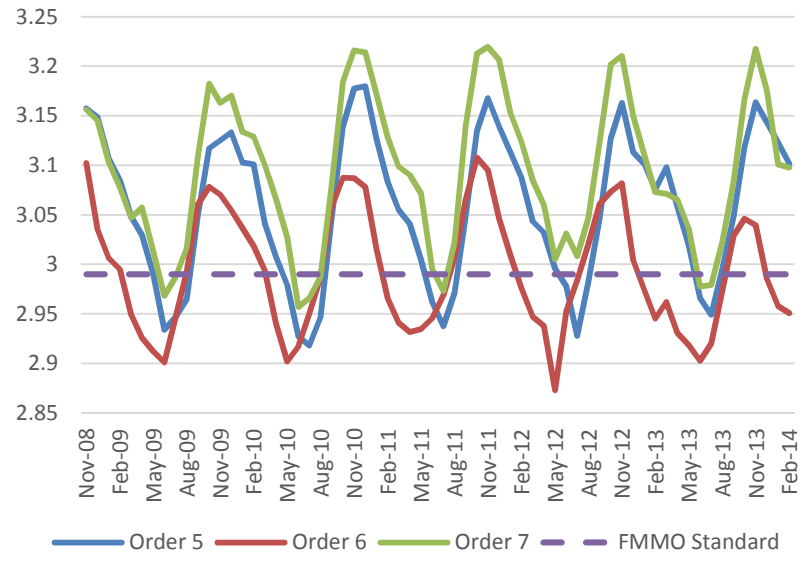
Higher, urban-based population and fewer manufacturing plants in the southeastern areas meant less efficiency recouped from higher component milk. But market conditions in the southeast have changed since Federal Order reform was implemented in 2000 and now those producers can also benefit from MCP.

Change in Utilization. In the 1990s, 80% to 87% of milk pooled in the Appalachian and Southeast orders went into Class I (fluid) products, and Class I utilization was expected to remain high. By 2013, however, Class I utilization of milk in the Appalachian and Southeast orders had dropped to 67% and 68%, respectively.

Purchase of Supplemental Milk. In 2000, 74% of Southeast order milk was produced inside the order. But since 2009, half of the milk marketed in this order has been procured from other areas. Similarly, the Florida order's milkshed has expanded from primarily Florida and Georgia producers to include the Carolinas and Virginia, Michigan, Ohio, and Indiana.

Securing supplemental milk creates ever-increasing challenges starting with the fact that milk purchased from surrounding orders must be paid for on an MCP basis. Producers with above-average components who are located in the border region of these orders can receive higher milk prices by marketing in the MCP orders rather than the fat-skim orders of the southeast. Plus, component averages are continually increasing in MCP orders *(see Figure 2, back),* making supplemental milk more valuable and more expensive to procure. This economic reality forces processors and cooperatives to go greater distances to secure milk needed to meet the demand for Class I milk in the Appalachian, Southeast, and Florida orders.

Fig. 1: Protein Test of Producer Milk, Southeast Orders



Higher Protein in Producer Milk. Another change is that in recent years, the protein level of producer milk has exceeded the order standard (2.99%), but because of fat-skim pricing, producers are not receiving credit for above-standard protein. Since late 2008 *(Figure 1, above),* protein tests in the Appalachian and Southeast orders exceed 2.99% a large majority of months, and about half the year in Florida.

Economist Dr. John Newton determined that under multiple component pricing (MCP), milk pooled on the Appalachian order would have been worth five cents more per hundredweight on average from 2006 to 2013; milk on the Southeast order would have been valued eight cents per cwt. higher. Florida's average milk value was unchanged compared to fat-skim pricing *(Tables 1 and 3)*. Going a step further, if producers increased the protein in their milk by just 0.05% *(Tables 2 and 4)*, milk under MCP pricing would have been worth eight and eleven cents in the Appalachian and Southeast orders, respectively, and Florida milk would have gained a penny in value on average.

Table 1. Dollar Difference in Total Producer Milk Value Under Multiple Component Pricing, 2006 - 2013

Year	Federal Milk Marketing Order		
	Appalachian	Southeast	Florida
	(Mil $)		
2006	1.73	3.63	(0.15)
2007	2.51	6.01	(0.26)
2008	2.75	5.33	(0.24)
2009	1.88	3.43	(0.16)
2010	2.60	4.61	(0.02)
2011	4.24	8.28	0.07
2012	4.23	7.20	0.08
2013	5.26	5.23	(0.36)
Total 2006 - 2013	**25.20**	**43.73**	**(1.05)**
Total All FMMOs			**67.88**

Table 2. Dollar Difference in Total Producer Milk Value Under Multiple Component Pricing, 2006 - 2013
Increase Protein by 0.05 p.p.

Year	Federal Milk Marketing Order		
	Appalachian	Southeast	Florida
	(Mil $)		
2006	2.78	6.03	0.10
2007	4.12	9.38	0.32
2008	4.10	7.87	0.20
2009	2.83	5.18	0.03
2010	3.88	6.62	0.22
2011	5.98	11.00	0.41
2012	5.74	9.55	0.38
2013	7.12	7.43	0.01
Total 2006 - 2013	**36.55**	**63.06**	**1.66**
Total All FMMOs			**101.27**

Table 3. Per Hundredweight Difference in Total Producer Milk Value Under Multiple Component Pricing, 2006 - 2013

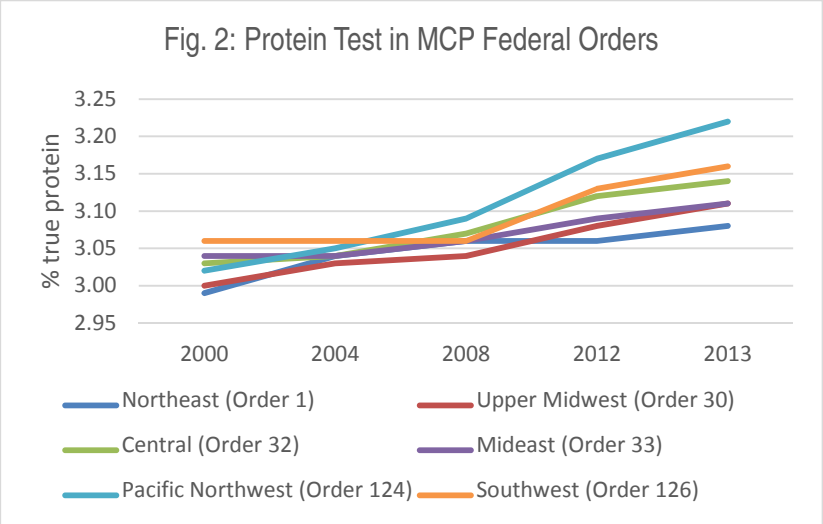
Year	Federal Milk Marketing Order		
	Appalachian	Southeast	Florida
	($/cwt)		
2006	0.03	0.05	(0.00)
2007	0.04	0.08	(0.01)
2008	0.05	0.08	(0.01)
2009	0.03	0.05	(0.01)
2010	0.04	0.07	(0.00)
2011	0.07	0.12	0.00
2012	0.07	0.11	0.00
2013	0.09	0.09	(0.01)
Average 2006 - 2013	**0.05**	**0.08**	**(0.00)**

Table 4. Per Hundredweight Difference in Total Producer Milk Value Under Multiple Component Pricing, 2006 - 2013
Increase Protein by 0.05 p.p.

Year	Federal Milk Marketing Order		
	Appalachian	Southeast	Florida
	($/cwt)		
2006	0.04	0.07	0.00
2007	0.07	0.12	0.01
2008	0.07	0.11	0.01
2009	0.05	0.07	0.00
2010	0.06	0.09	0.01
2011	0.10	0.16	0.01
2012	0.10	0.14	0.01
2013	0.12	0.12	0.00
Average 2006 - 2013	**0.08**	**0.11**	**0.01**

Notes
1/ Based on the following elasticity estimates: butterfat to protein of 0.53 and other solids to protein estimated at 0.001.
2/ SCC adjustments approximated using market average SCC levels.
3/ Class I producer milk value and class II - IV milk value in fat remain unchanged under MCP pricing.
4/ Positive values indicate value added under multiple component pricing order.

MCP would not only more accurately value milk today in the southeastern orders, it would also continue adding value in the future as producers respond to economic signals. Figure 2 *(right)* shows the increase in average producer protein test from 2000 to 2013 for the six existing MCP orders. Paying for protein through MCP incentivizes additional protein production, adding value for producers and efficiency for processors.



Changing the pricing system in the three southeastern orders will require a hearing through the Dairy Programs division of the USDA Agricultural Marketing Service. NAJ is working with cooperatives and producer groups in the southeast on this issue. Implementing MCP would more accurately reflect the value of producer milk in today's dairy economy. Uniform regulated pricing systems for milk east of the Rocky Mountains would result in a more orderly flow of milk to its greatest need and value. Processors would be able to attract supplemental milk from outside the orders without incurring price risk from buying milk on MCP but selling on a fat-skim basis. Lastly, producers would receive the economic incentive to increase component production, as has happened in the existing six MCP orders.

The time is right for the next big step in federal order reform: extending equitable milk pricing to all producers.

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