In Partnership with American University School of International Service, National Family Farm Coalition, and Rural Coalition

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To: XXXX
From: Forrest McGraw
CC: XXXX
Date: May 6, 2014
Re: Reforming Milk Prices to Save Dairy Farmers

Dairy Policy Memo

Dear XXXX,

The aim of this policy memo is to consider several issues in our dairy industry. In the past 10 years, for example, the number of dairy farms in the U.S. has diminished from 117,000 to 65,000,[1] and dairy processing plants have coalesced—while expanding in size by 70 percent.[2] This policy memo will examine major problems with antitrust enforcement, the farm-gate milk prices and the causes of milk price problems, as well as provide recommendations for addressing these issues.

The first issue we seek to ameliorate is the lack of effective enforcement for free and fair competition in agriculture. This research brings to the fore the role of the Antitrust Division (the Division) of the U.S. Department of Justice (DOJ) and the U.S. Department of Agriculture (USDA); agencies which together hosted a series of workshops titled Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy. Unfortunately little progress has been made towards establishment of free and fair competition in agriculture, therefore we propose taking action toward tighter federal merger enforcement as one solution. This action would serve to further investigate, evaluate and correct the anti-competitive behaviors that currently exist in the dairy industry.

The second issue this policy memo addresses is the pricing of milk. These issues include below-cost, volatile, and flat-rate pricing, which are all discussed below. There is now general agreement among dairy farmers, legislators and agriculture officials that dairy farmers are struggling to maintain their way of life, while supermarkets are earning unequivocal profits of at least $1.00 to $1.50 per gallon—possibly more.[3] We have cited the groundbreaking research of Professor Rob Cotterill, who suggests that one way to redistribute wealth to dairy farmers is to charge a fee to retailers.[4] Ultimately, the pricing of milk should be based on the cost of producing it and garner enough profit to provide dairy farmers with a livable wage.

The following quote given by Joel Greeno at the Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy workshop puts into context the struggle of American dairy farmers today, and the urgent need to address the problems we highlight:

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[1] Hauter, Wenonah. "Milking the System." In *Foodopoly*: the battle over the future of food and farming in America. (New York: New Press, 2012), 214.
[2] Locke, Leslie. "Highlights of the 6/25/10 DOJ/USDA Public Workshop Wisconsin." Report from the *Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy* conference held by U.S. Department of Justice and U.S. Department of Agriculture (2010): 1-6.
[3] Rabinowitz, Adam N., and Ronald W. Cotterill. "The Need for New Milk Pricing Policies." *Connecticut Legislature Environment Committee* (February 18, 2009) (2009).
[4] Rabinowitz, *Connecticut Legislature Environment Committee*, 2009.

> We know of nearly one hundred dairy farmers that have committed suicide to date since the '08 crash. It's got to stop… Dairy farmers deserve dignity. They deserve justice. They deserve cost of production plus profit.[5]

Background on 'Agriculture and Antitrust Enforcement Issues' Workshop

In 2010, the Antitrust Division (the Division) of the U.S. Department of Justice (DOJ) and the U.S. Department of Agriculture (USDA) hosted a series of workshops titled Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy. The Division sought to create fora for discussing ideas to best promote free and fair competition in agriculture. Assistant Attorney General (AAG) Christine Varney, in her inaugural remarks, stated, "agriculture is an essential part of the American economy" and "well-functioning agricultural markets are not only a matter of economic efficiency, but a matter of national security and public health." Furthermore, these workshops provided attention to several important issues in the dairy sector: low milk prices at the farm; the gap between farm and retail prices for milk; consolidation and concentration at the processor and retailer levels; dairy cooperatives; and the role for regulatory enforcement and antitrust in the dairy industry.

Massive changes in the dairy industry are a response to the retail market, as consolidation in the grocery industry dramatically drives consolidation in all sectors of the dairy industry—from mega-cooperatives, fluid milk processors, and dairy product manufacturers—creating powerful alliances for profitable, giant factory farms.[6] This market power allows the retailers and buyers to push down the prices farmers receive for milk.[7]

On June 25, 2010, Ron Cotterill addressed the USDA and DOJ about his research on "channel consolidation"—a label also known as "channel efficiency"—that describes the way that market channels compress or coalesce (join forces) to simplify "efficiencies" for mutual benefit. Unfortunately Cotterill's findings are that: the efficiencies are not passed on to the farmers or consumers; instead, in the dairy industry, a "lion's share" of the margin stays with the processors and retailers. Indeed, the buyer-power (in the middle) is subsidized by the ends (the producers and the consumers) representing cheap food policy in favor of corporate America.

Problems and Causes of Milk Prices Today

We have provided a list of the problems and causes for many of the problems that are seen in the dairy industry.

Problems with farm milk prices:

1. <u>Prices are volatile and below-cost.</u> This is the most critical issue facing dairy farmers. General agreement among dairy farmers, agriculture officials, and legislators depict milk prices at the farm to be far too low. Farmers need to be provided the cost of production plus profits.
2. <u>The prices consumers pay for dairy are not responsive to farm milk prices</u>. Consumers are paying approximately 50 percent below the average cost of production.
3. <u>The dairy farmers' share of consumer dollar spent on dairy products is continuing to fall.</u> For example, the retailer's margin on fluid milk has risen from 20 percent to 40 percent since the 1990s.[8]

Causes of milk price problems

1. <u>Consolidation of grocery retailers and dairy processors:</u> These are the most severe pressures causing low farm prices. The top four dairy cooperatives in the U.S. control 40% of all fluid milk sales; indeed, when added together with Dean Foods, the largest dairy company in the country, these five entities make up 80% of all fluid milk sales.[9]
2. <u>Lax enforcement of federal regulations:</u> This is occurring in merger policy, which undermines the competitiveness of a free market and the antitrust laws established in the United States.
3. <u>De facto vertical integration:</u> This occurs when large grocery retailers finance mega-dairies.

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[5] Greeno, Joel. *Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy*, DOJ and USDA Public Workshops Exploring Competition Issues in Agriculture, University of Wisconsin--Madison, (June 25, 2011) (2011).
[6] USDA, "Economic Effect of U.S. Dairy Policy and Alternative Approaches to Milk Pricing," report to U.S. Congress (2004): 17-18.
[7] Shields, Dennis. "Consolidation and Concentration in the U.S. Dairy Industry," Congressional Research Service (April 27, 2010) (2010).
[8] Bunting, Sherry. "Economist: 'Cheap food policy is bankrupt'" Part II of DOJ/USDA hearing in Wisconsin (2010).
[9] Hauter, *Foodopoly*, 220.

4. Federal Milk Marketing Order (FMMO) is outdated and convoluted: This system is controlled by a small number of large cooperatives that use the FMMO system to reduce competition and protect their own market shares.[10] This program is also responsible for the flat-rate pricing for different prices of milk.
5. Cheap food policy is "cheap" for corporate America, but expensive for producers and consumers as the "lion's share" of the money stays with the processor and retailer.[11]
6. Thin trading on the Chicago Mercantile Exchange (CME) spot cheese market is a possible cause of farm milk price volatility.[12]

Margin Pricing for Redistribution to Farmers

Cotterill suggests using market policy to redistribute retail profits back to dairy farmers. There is room within the "marketing channel"—concerning the $1.00 to $1.50 profit per gallon of milk sold in supermarkets—that can be redistributed to farmers. Collecting a fee from retailers and paying that fee back to the farmers can obtain a redistribution of cost of production plus profits for dairy farmers.

In addition to retail profits, flat milk pricing is a serious problem. Flat pricing occurs when supermarkets charge the same price for skim milk as they do for 2% and 1% milk. Skim milk costs retailers less than whole milk and a competitive market would reflect these cost differences. Flat milk pricing highlights direct evidence of market failure; large firms set retail prices instead of market forces. The result of flat pricing is that retailers make higher profits on milk regardless of butterfat since they pay less for such milk. Passing legislation to require retailers to price milk in a fashion that reflects the cost of butterfat in milk should be put into action.[13]

Recommendations

Tighten federal merger enforcement. There is a need to vigorously enforce federal merger laws in the dairy industry. At this point, a lack of effective federal merger laws against mergers in the dairy sector causes a reduction in competition in the marketplace—this is neither fair nor free competition. Providing such an act would require all players to adhere to pro-competitive rules. Unfortunately, the DOJ has allowed select divestitures to cure antitrust objections to proposed mergers, which do not work. It is the work of the DOJ to concern itself with the mergers that lessen competition and reconsider their own effectiveness on this issue.

Change Federal Milk Marketing Order (FMMO) formulas. Positive feedback was given at the 2010 Antitrust Workshop; dairy farmers even claimed that this is the most opportune time in 45 years to make a change to the FMMO system and the way it does business.[14] This will help to reduce price volatility by stopping "end product pricing." The use of the current formula to derive market order price for milk from market prices of manufactured milk products like cheese is convoluted and outdated. Using the current formula is not working—further research is needed.

Legislative change is necessary. It is necessary that dairy farmers receive a higher share of the consumer dollar, a more competitive market channel, and a more stable price for milk. "Going after the margin," as Ron Cotterill has proposed in his channel dairy distribution research, collects a fee from retailers that can then be paid back to farmers.

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[10] Bunting
[11] *Ibid*.
[12] Hauter, *Foodopoly*, 214.
[13] Rabinowitz
[14] Bunting