

Who or what sets the organic milk farmgate price?

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The last six months have seen many changes within the organic dairy landscape, with class action lawsuits and headlines about abuse of standards, consumer trust and corporate greed. What hasn't made headlines is that organic dairy farms are starting to lose money, with many producers putting off necessary investment in their operation and essential family expenses, and some deciding to return to conventional production. Despite an ongoing dialogue between NODPA, FOOD Farmers and the processors that has spelled out the impact of large increases in cost of farm inputs, processors have offered less than a 4% annual increase in base pay price. The latest contracts include a dazzling array of seasonal bonuses and benefits that will vary with each farm, weather conditions, and the price of purchased feed, requiring a post graduate degree in accounting and a crystal ball to evaluate all the permutations that will allow the producer to assess the impact on their net farm income. One of the main reasons many producers transitioned to organics was to get a higher and more stable pay price; however, we now have complicated contracts and coop agreements that change from month to month, may require specific forms of farm ownership structures, some with ill-defined animal welfare standards, and other market conditions that may be bound by enforced confidentiality clauses.

The organic dairy industry is built on strong partnerships between the processors and producers in the knowledge that an economically sustainable pool of producers will provide the security those processors need to expand their markets and product lines. In 2005, producers faced a similar situation where they were losing money and the processors responded with a staggered increase of up to \$4 per cwt over a four month period. In January 2006, the base price plus the Market Adjustment Premiums (MAP) for New England and the Northeast was averaging \$26/cwt for Horizon, HP Hood and Organic Valley.

In January 2008, the New England base price plus MAP for Horizon is projected at \$26.25, for HP Hood \$26.90 and for Organic Valley \$27, with seasonal bonuses that vary from \$3 for 4 months to as little as \$0.50 for two months. The effect on net income of the seasonal bonuses are difficult to assess on a region wide basis as the impact is subject to many variables, including unpredictable weather or crop conditions, and the price of purchased feed. Moving into the Midwest, farmgate prices for producers drop by as much as \$4.50/cwt even though USDA studies show that operating costs are around the same as the Northeast. Producers in the Midwest and the west average a base price of around \$22.50/cwt. The determination of pay price in other parts of the country follows the same pattern as in the Northeast, with little variance between processors. There are many "farmyard" deals that are made for higher base prices if producers are nearer to milk processing plants or on a route that is under-subscribed. Some of these deals are reported to be as high as \$30 per hundred as a base price plus MAP and have confidentiality clauses to prevent producers exchanging information, which seems to happen anyway. Processors also "exchange" milk with each other from areas in surplus (the west for example) to satisfy markets in the east.

Table 1: Overview of pay-price in New England

	Horizon Organic		Organic Valley*		HP Hood	
	2006	2008	2006	2008	2006	2008
Base price	24.00	25.00	26.00	27.00	26.00	24.90
MAP	2.00	1.25			-	2.00
Short (2 to 4 months)	1.50	3.00		**	2.00	2.00
Long (8 months)	0.75	1.50				
Trucking charge/yr	-	-	\$900	\$900	-	-
Average year round price***						
Long program	26.50	27.25				
Short program	26.50	27.25	26.00	27.00	26.50	27.40

*Organic Valley requires producers to purchase preferred stock equivalent to 5.5% of their annual base gross income; historically this investment has a 8% return on required amount in Class B Stock. Profit sharing is activated if Organic Valley's 2.2% profit goals are met or exceeded.

**\$1.00/cwt for milk produced in Oct, Nov, Dec, provided the average is greater than the average for May, June, July.

*** Seasonal bonus paid is multiplied by the number of months and divided by a complete calendar year.

Components and quality pricing varies with each company. Organic Valley is the only company to deduct money for poor quality. With components, pricing varies from using the Federal Milk Marketing Order (FMMO) to a fixed price within the contract. Depending on farm operating practices and the breed of cows, components and seasonal and quality payments can increase gross income by as much as \$3/cwt.

Table 2: Component payments by company measured by \$/lb

	Organic Valley	Horizon Organic*	HP Hood	FMMO- Nov 07	
	2008	2008	2008	2006	2007
Butterfat	2.0	1.82	FMMO	1.39	1.41
Protein	1.86	1.56	FMMO	2.24	4.31
Other solids	1.65	0.25	FMMO	0.23	0.25

*Horizon offers a choice of 3 programs, one just for butterfat (\$0.13 BFD/.1 point+/-3.5%BF), one as above and one using the FMMO.

Table 3: Quality premiums offered by company measured by \$/cwt

Volume Premium	HP Hood	Horizon	Organic Valley*
>750 cwt/ month	\$0.15	\$0.15	None
>1,500 cwt/month	\$0.30	\$0.30	None
>3,000 cwt/month	\$0.50	\$0.50	None
Low Standard Plate Counts			
>9 and <16,000	\$0.05	\$0.05	11-20,000@\$0.10
>5 and <8,000	\$0.15	\$0.15	0-10,000@\$0.25
<6,000		\$0.28	
4,000 or less	\$0.25	\$0.37	
Low P. I Counts			
>17 and <32,000	\$0.20	\$0.28	\$0.25
>9 and <16,000	\$0.35	\$0.56	0-15,000@\$0.50
<12,000		\$0.84	
<8,000	\$0.75	\$1.25	
Low Somatic Cell Counts			
>251,000 and <300,000	\$0.25	<300@\$0.38	
>201,000 and <250,000	\$0.50	<225@\$0.75	\$0.48
>151,000 and <200,000	\$0.75	<175@\$1.13	
<150,000	\$1.00	\$1.50	\$0.96

*OV has a Lab Pasteurization Count (LPC) payment of 0-51 @ \$0.50/cwt; 15-100 @ \$0.25/cwt. LPC is a laboratory test involving heat treatment of bulk milk samples at 145°F for 30 minutes.

Each company has its own transition incentives and programs that provide other than cash benefits. Space limits a full description of these programs but they include Horizon Organic's HOPE program and Organic Valley's centralized grain purchasing and veterinary helpline, plus support staff from all companies.

How is the farmgate price set?

- Not by Government - Organic milk is neither directly subsidized nor supported and its farm gate price is not set by the federal government, despite the fact that all processors, with the exception of Aurora Organic Dairy, pay into the federal pool.
- Not by the retail price - The farmgate price bears no relationship to the retail price, which is set by supermarkets based on competitive wholesale pricing between processors, in-store promotions and an average margin of 31% for their operating expense and profit. The same ½ gallon of milk can vary by as much as \$2, retail price, within a 5 mile radius.
- Not as a percentage of retail price - In most years, organic dairy farmers receive a smaller percentage of the consumer dollar than the conventional farmer, 34% for organic compared to 41% for conventional (based on a farmgate price of \$15 and a retail gallon price of \$3).
- Not by Parity Pricing - Parity price¹ for November 2007 was \$41.20 (up \$.50/cwt from Oct. '07) for Midwestern milk; with regional premiums added to that, bringing it up to about \$45/cwt in the Northeast.
- Not by comparison to conventional dairy - Conventional farmgate prices rose by as much as \$10 per cwt in 2007 without any increase in the organic farmgate price.
- Not by supply and demand - Consumer demand for organic dairy is still growing by at least 20% a year while family farm organic dairies are losing money and returning to conventional production.
- Not by national negotiation - Most contracts are with individual farms except those that are contracting with Dairy Marketing Services, and a majority of producers have confidentiality clauses.
- Not by costs of production - The pay price offered for 2008 is evidence enough.

It should be enough that producers clearly state their case, providing evidence of increasing costs of farm inputs, for processors to respond to their member-owners and farm partners and negotiate an increase in the base pay price that will keep farm families in business. Individual producers have tried and failed with this approach as have formal and ad hoc groups of producers across the country, and FOOD Farmers has presented a national voice of concern which has so far been ignored.

Why is a 20% increase needed?

NODPA and FOOD Farmers have been proactive in asking for a 20% increase in base price incorporating the MAP and the retention of quality and component programs. This increase would return producers to the same level of profitability they had in 2006. Producers have also volunteered to work with consumers in explaining any increase in retail price that might be necessary to save family farms from bankruptcy.

In order to highlight the effect of low pay prices on farm profitability, we have used the research by USDA Economic Research Service (ERS) completed in 2007 using 2005 data, and the ongoing multi-agency study led by the Universities of Vermont and Maine to supplement the anecdotal information supplied by producers. Both these studies reported similar data for northeast organic dairy farms. Table 2 uses data from the ongoing study in Vermont and Maine and makes projections for 2006-2008 based on

¹ The Agricultural Adjustment Act of 1938 states that the parity price formula is "average prices received by farmers for agricultural commodities during the last ten years and is designed to gradually adjust relative parity prices of specific commodities".

existing market knowledge. “Farmgate milk sales” assumes up to \$3 for a combination of components, quality and seasonal payments, and is representative of actual farmgate prices. The table reflects the large increase in purchased feed and energy costs documented by many agencies. We use the actual percentage increase between 2004 and 2005 as the basis for increases in other line items. It is evident that in 2006 there was profitability before taking depreciation or equipment/facility replacement into account. In 2007, the increase in income from bonus programs has mitigated losses for those farmers with high component herds who are being paid for components based on FMMO. The final column shows a 20% increase in the base pay price plus assumes an extra \$3/cwt from bonus programs which brings producers back to the level of profitability they had in 2006.

Table 4: Organic Dairy income and expense per cwt based on a 50 cow herd

	Actual		Projected on actual pay price			20% increase in base 2008
	2004	2005	2006	2007	2008	
Farmgate milk sales	22.97	24.94	28.00	30.00	31.50	35.00
Cattle	1.08	1.29	1.55	1.86	2.23	2.23
Crop sales	0.11	0.19	0.29	0.43	0.64	0.64
Other	1.67	1.78	1.87	1.96	2.06	2.06
Total Income	25.83	28.20	31.70	34.25	36.43	39.93
Expenses						
Auto + truck exp	0.40	0.37	0.39	0.41	0.43	0.43
Bedding	0.43	0.51	0.56	0.62	0.68	0.68
Custom hire	0.37	0.58	0.70	0.84	1.00	1.00
Total feed cost	9.10	9.25	10.18	13.23	17.20	17.20
Fuel, oil, utilities	1.58	1.99	2.29	2.63	3.03	3.03
Interest	1.04	1.10	1.16	1.21	1.27	1.27
Labor	2.10	2.44	2.68	2.95	3.25	3.25
Marketing	0.44	0.42	0.44	0.46	0.49	0.49
Real Estate Tax and Insurance	1.18	1.17	1.21	1.24	1.28	1.28
Rent	0.10	0.43	0.45	0.47	0.50	0.50
Repairs	1.31	1.90	2.09	2.30	2.53	2.53
Vet, medicine, breeding, DHIA	0.79	0.83	0.87	0.92	0.96	0.96
Other: misc	0.21	0.56	0.59	0.62	0.65	0.65
Total Expenses	19.05	21.55	23.60	27.89	33.25	33.25
Depreciation	2.81	2.81	2.81	2.81	2.81	2.81
Net farm income	3.97	3.84	5.30	3.54	0.37	3.87
\$40,000 owner draw	6.29	6.64	6.68	6.68	6.68	6.68
Net Farm Income	-2.32	-2.80	-1.38	-3.14	-6.31	-2.81

Is it the same old story?

Recently, I was at a meeting of producers where price was being discussed and an Extension educator remarked that, “dairy farmers have been losing money for many years but still continue to farm, why should organic dairies be any different?” Is organic dairy going to be business as usual with cyclical changes in profitability bringing about family farm crises and a continued movement to larger organic dairies who can take advantage of economies of scale? Production costs are not going to be reduced in the

foreseeable future and producers have no control over the cost of purchased feed, fuel, labor, utilities and essential repairs to equipment and facilities. If processors truly value their producer-partners and member-owners, now is the time to negotiate realistic increases to pay price across the country that reflect the very real cost of doing business and maintaining the family farm, restoring confidence in organic dairy, and encouraging new entrants.