

Post-Hearing Brief
Temporary Price Adjustment and Whey Valuation Hearing

Richard J. Sexton
Agricultural and Resource Economics Department
University of California, Davis

During the course of my testimony at the hearing on September 12, 2013 regarding Temporary Price Adjustment and Whey Valuation, I requested the opportunity to submit a post-hearing brief. I hereby submit the following brief containing two items: i) additional information on reasons underlying the negative operating margin of Washington State. This item is submitted in response to a question posed to me by one of the hearing officers, and ii) a copy of the visual presentation that accompanied my testimony. This latter item has been augmented from what was presented at the hearing to provide full documentation of data sources used in preparing the slides.

(i) Washington State Operating Margins

The state of Washington is contained within the Pacific Northwest Federal Milk Marketing Order (FO 124). Although California and Washington have similar milk utilization rates (i.e., allocation of raw milk across classes), the Washington price for milk has been higher than the price paid in California since 2008.¹ This is due, at least in part, to Washington being a part of the Federal Milk Marketing Order System wherein the farm price reflects the value of the whey that can be manufactured from the milk.

Washington and California are both subject to extremely high feed costs given their distance from major hay and grain producing regions. In both states, purchased feed costs accounted for 79% of total feed costs in 2012,² demonstrating that both states rely heavily upon feed that is purchased and transported significant distances, raising feed costs relative to other states. Purchased feed costs account for 56 and 51 percent of total costs for California and Washington, respectively in 2012.³ With feed accounting for over half of all costs incurred by dairies and increasing export competition in the Western U.S. for alfalfa,⁴ it is not surprising that these states have had low or negative operating margins. For 2012, the year indicated on the chart exhibited during my testimony, Washington's feed costs were about \$2.00 per cwt. higher than for California, and other operating costs were about \$1.00 per cwt. higher, causing Washington's operating margin to be even lower than California's, despite Washington farmers receiving a higher milk price through the federal order.

¹ United States Dept. of Agriculture, Economic Research Service. Milk Cost of Production Estimates 2008 – 2012. Available at:

http://www.ers.usda.gov/data-products/milk-cost-of-production-estimates.aspx#Ujh9Nrwd6_B

² Ibid.

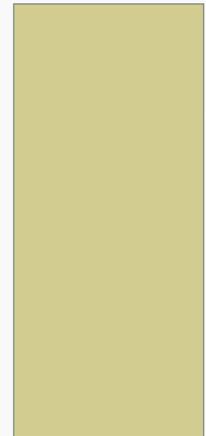
³ Ibid.

⁴ Hoyt, S. "California and Western U.S. Hay and Forage Market Trends." California Alfalfa and Grains Symposium, Sacramento, CA Dec. 10-12, 2012. Available at: <http://alfalfa.ucdavis.edu/+symposium/proceedings/2012/12-01.pdf>

TEMPORARY PRICE ADJUSTMENT & WHEY VALUATION HEARING

RICHARD J. SEXTON

AGRICULTURAL & RESOURCE ECONOMICS; UC DAVIS



BACKGROUND

- California milk prices became disconnected from the market in 2008 when CDFA removed whey value as a component of the 4b (cheese) price and replaced it with a flat \$0.25/cwt. allowance
- Change made in 2011 to replace \$0.25 allowance with a sliding \$0.25 - \$0.75 allowance did not solve the problem
- 43% of CA milk is now used to manufacture cheese, so the pricing disparities and economic distortions caused by this decision are large

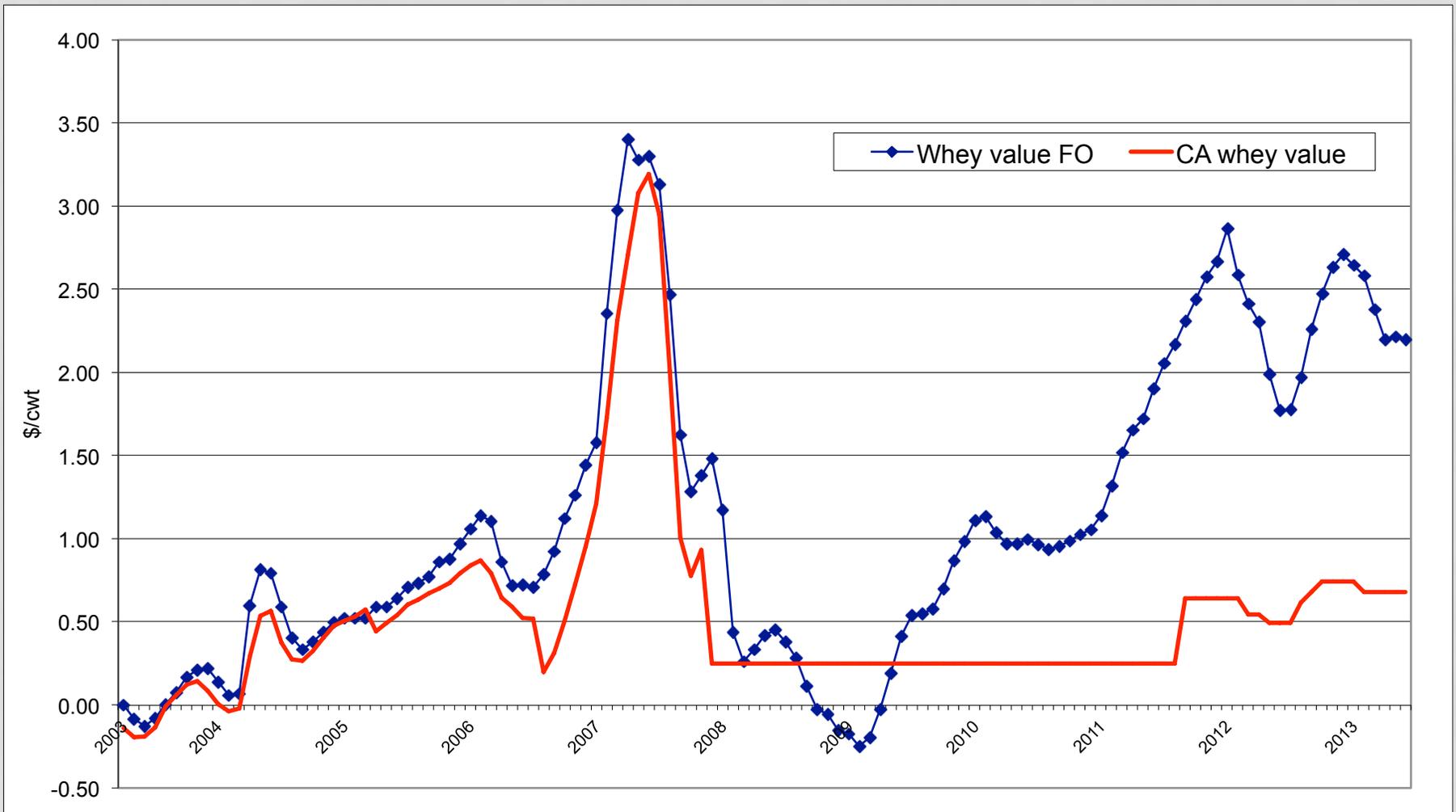
IMPLICATIONS OF WHEY VALUE DISCONNECT

- CA dairy farmers receive a lower price than their peers in most other states
- Low prices coupled with higher operating costs in CA due to run up in feed and shipping costs have caused negative operating margins for CA farmers
- CA farmers cannot use the CME to hedge risk due to disconnect between CA farm price and market
- CA lost 1 percentage point of its national market from 2008, when the change was implemented, through 2012
- Evidence suggests CA market share is falling rapidly in 2013 as farms go out of business

IMPLICATIONS (CONT.)

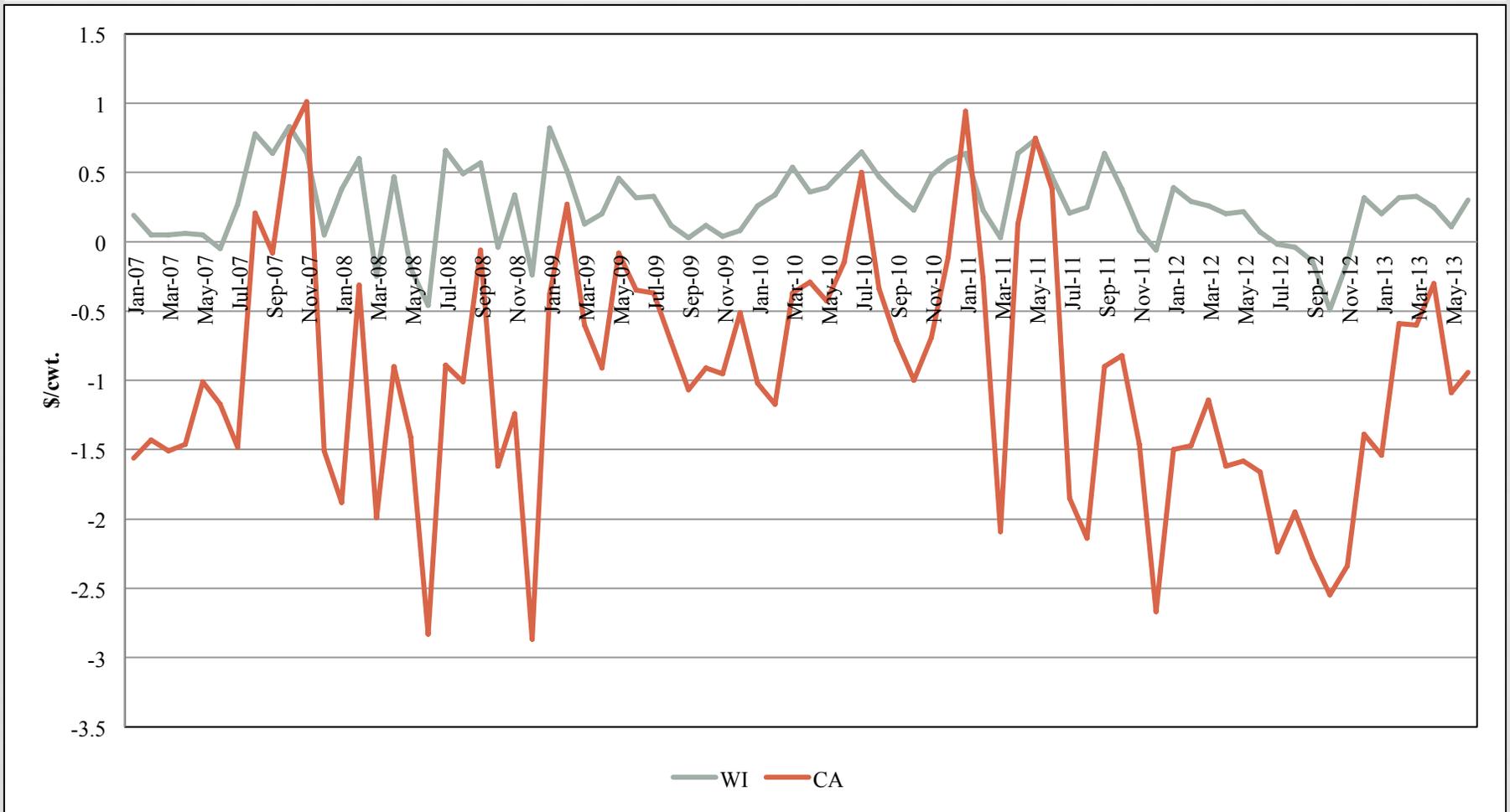
- CA has lost nearly 300 dairy farms between 2008 – 2012
- If current losses persist more dairy farms will inevitably go out of business
- Approximately 15,000 CA jobs in total (most in areas of high unemployment) have been lost from exit of farms and reduction of CA herd size since 2008
- Lack of requirement for cheese manufacturers to pay a market value for whey subsidizes cheese production in CA relative to other dairy products
 - Most CA cheese is exported out of state

WHEY VALUE, CLASS III VS. CLASS 4B



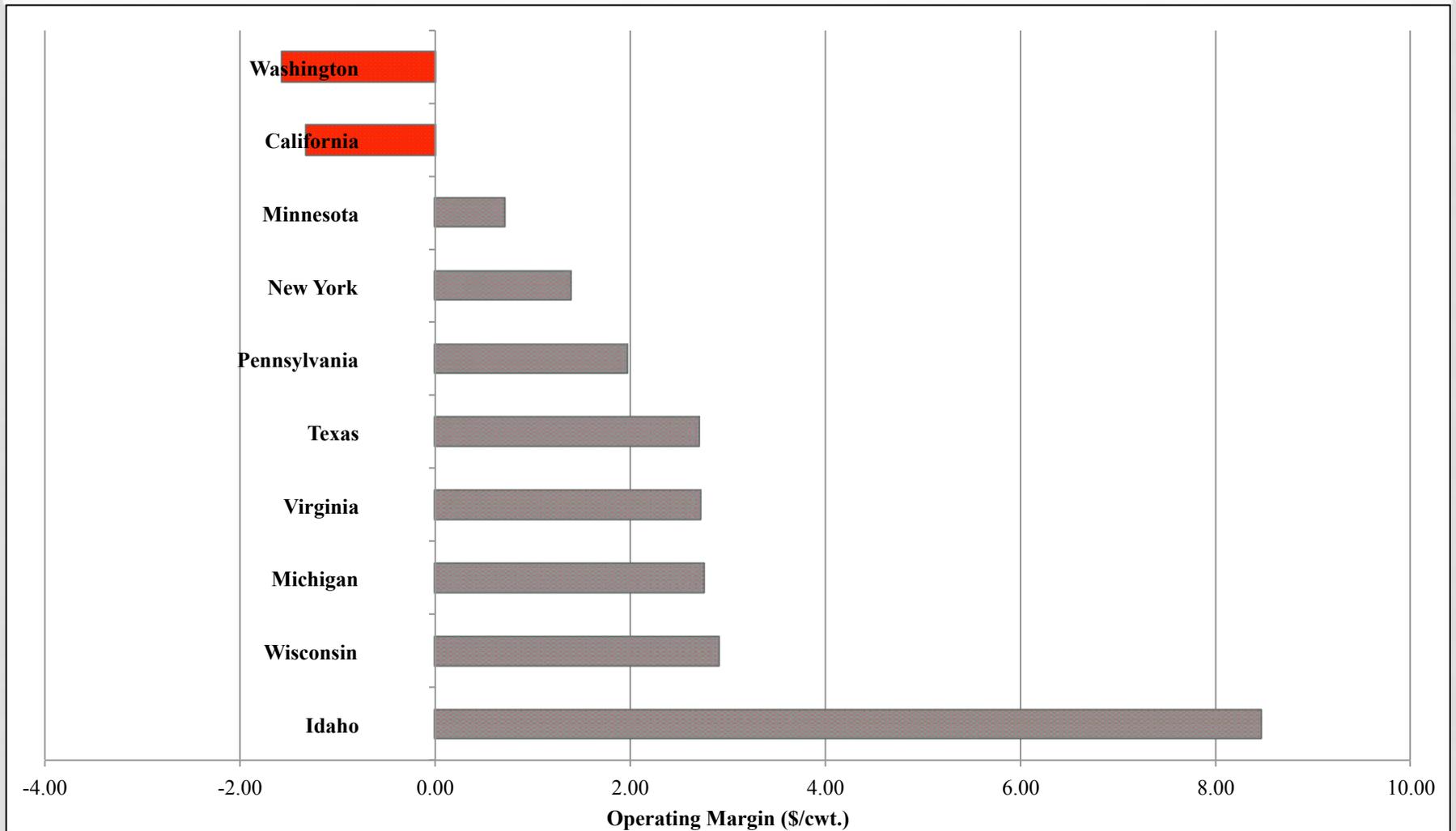
Sources: i) **Federal Order:** United States Dept. of Agriculture, Milk Marketing Order Public Statistics Database. Class III Price, Apr. 2003 – Jul. 2013. Available at: <http://apps.ams.usda.gov/USDAMIB/Main/Welcome.aspx>. ii) **California:** California Dept. of Food and Agriculture, Marketing Services Div., Dairy Marketing and Milk Pooling. California 4b Price, Apr. 2003 – Jul. 2013. Available at: http://www.cdffa.ca.gov/dairy/prices_main.html.

UNIFORM PRICE - CLASS III PRICE



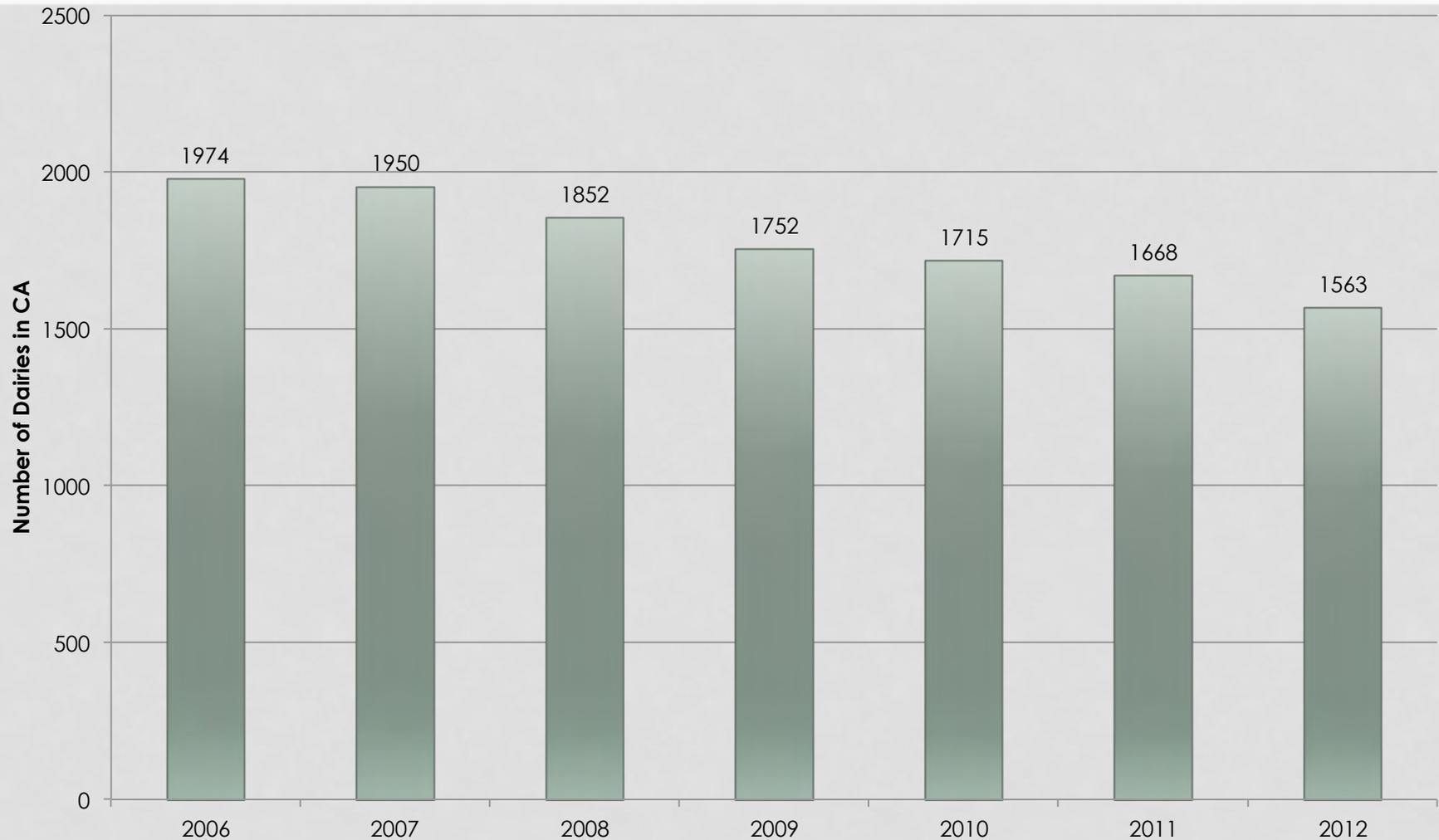
Sources: i) **Wisconsin:** United States Dept. of Agriculture, Milk Marketing Order Public Statistics Database. Upper Midwest Marketing Order Uniform and Class III prices, Jan. 2012 – Jul. 2013. Available at: <http://apps.ams.usda.gov/USDAMIB/Main/Welcome.aspx>. ii) **California:** California Dept. of Food and Agriculture, Marketing Services Div., Dairy Marketing and Milk Pooling. California Overbase Price, Jan. 2012 – Jul. 2013. Available at: http://www.cdfa.ca.gov/dairy/prices_main.html.

OPERATING MARGINS, BY STATE 2012



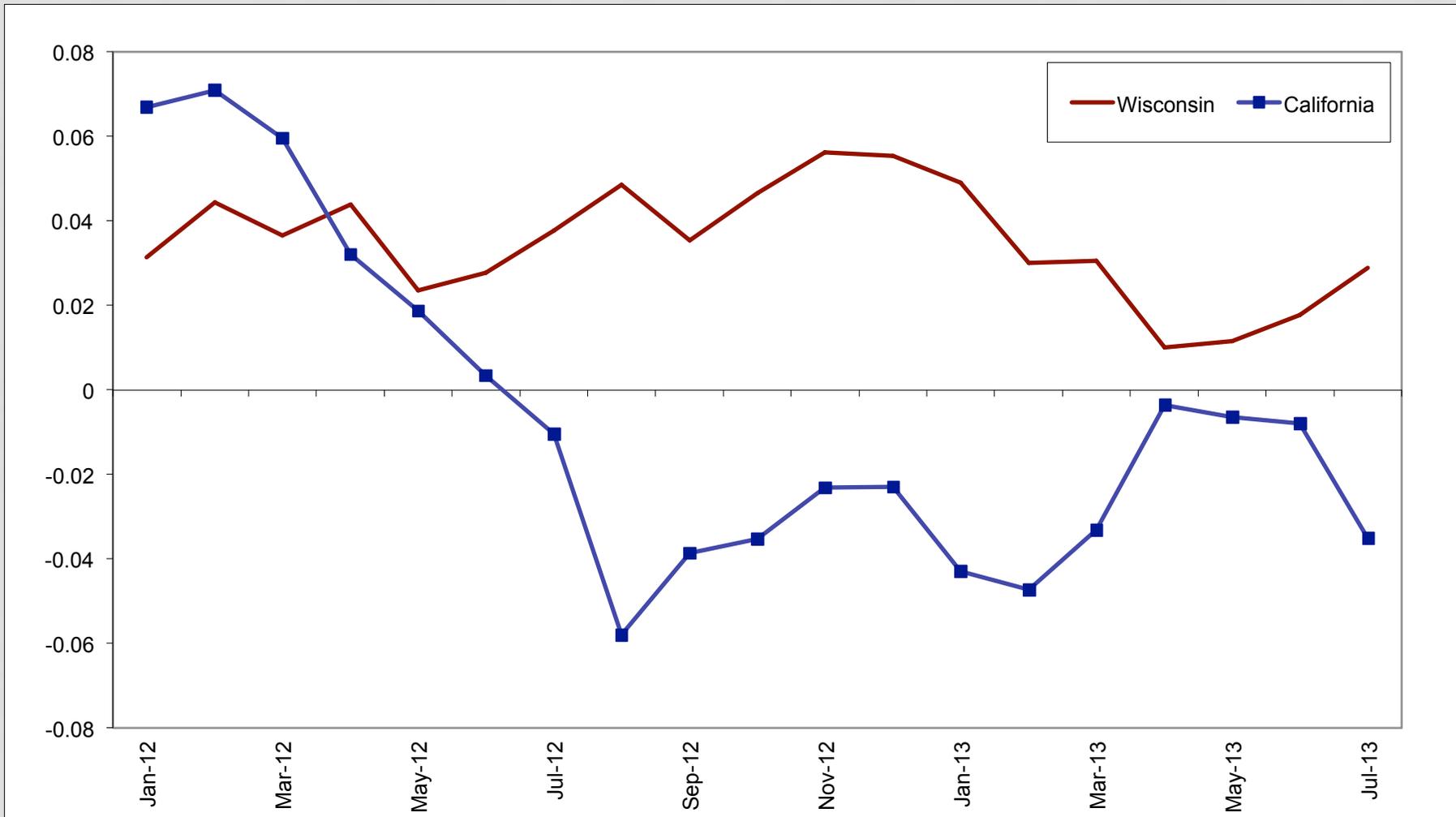
Source: United States Dept. of Agriculture, Economic Research Service. Milk Cost of Production by State, 2012. Available at: <http://www.ers.usda.gov/data-products/milk-cost-of-production-estimates.aspx#.Ujcy0LyE6Xh>.

DAIRIES IN CALIFORNIA



Source: California Dept. of Food and Agriculture, Dairy Marketing and Milk Pooling. Annual Dairy Statistics Summary, 2006-2012. Available at: http://www.cdfa.ca.gov/dairy/dairystats_annual.html.

MILK PRODUCTION - YEAR-OVER-YEAR PERCENTAGE CHANGE



Source: United States Dept. of Agriculture, National Agricultural Statistics Service. Milk Production by State, Jan. 2012 – Jul. 2013. Available at: http://future.aae.wisc.edu/data/monthly_values/by_area/99?year=2012.

EMPLOYMENT CREATED BY CA DAIRIES

- In 2008, California dairies created 443,574 jobs (CMAB study)
- Approximately 0.24 jobs per cow based upon 2008 herd size of 1,882,746

Year	Dairy Cows	Change from Previous Year	Reduction in Employment
2008	1,882,746	-	-
2009	1,847,660	-35,086	8,266
2010	1,858,028	10,368	-2,443
2011	1,836,112	-21,916	5,163
2012	1,819,760	-16,352	3,853
		<i>Total since 2008</i>	<i>14,839</i>

Sources: i) **Dairy Cows:** California Dept. of Food and Agriculture, Dairy Marketing and Milk Pooling. Annual Dairy Statistics Summary, 2008-2012. Available at: http://www.cdfa.ca.gov/dairy/dairystats_annual.html; ii) **Job Loss:** California Milk Advisory Board, "California Dairy Industry Remains a Powerful Job Creator." Available at: <http://www.realcaliforniamilk.com/farm-life/sustainability/economy/>.

UNEMPLOYMENT RATES IN MAJOR DAIRY COUNTIES (JULY 2013)

County	Unemployment Rate
Fresno	12.5%
Kern	11.6%
Kings	12.6%
Madera	11.3%
Merced	14.6%
Stanislaus	12.9%
Tulare	13.8%
<i>State Total</i>	<i>9.3%</i>

Source: State of California, Employment Development Dept., Labor Market Information Division. Report 400 C, Monthly Labor Force Data for Counties, July 2013.

RECOMMENDATIONS

- Adjustment proposed by CA dairies does not realign class 4b price with the market, but it represents a step in the right direction and a marked improvement over the current whey-pricing formula
- Implementing the recommended changes will reduce the losses being incurred by CA dairies and mitigate the exit of dairies and jobs from the market and reduction in size of the CA herd
- CA cheese plants will not be disadvantaged relative to their competitors in other states