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## Explanation of Farmer Benefits of the Proposed Connecticut Milk Pricing Laws

## Presented to Connecticut Farm Bureau Dairy Committee and Litchfield Dairy Committee Joint Meeting

by

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**April 21, 2003**

**by**

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# Explanation of Farmer Benefits of the Proposed Connecticut Milk Pricing Laws

**by Ronald W. Cotterill**

**Introduction:**

Farmers want to know how this proposed law will benefit them. This briefing paper explains in a general fashion how the proposed law benefits farmers. Actual benefits from the law will depend critically on the detailed regulations that the Commission promulgates. Those details will include the price collar rates at wholesale and retail, the raw milk price that the wholesale collar is applied to (for example, we propose using the average price of raw milk used by processors for products: whole – 3.25%, 2%, 1% and skim), and any special allowances/exemptions for small retailers and the added cost of delivery to them. Understand, however, that the bulk of all fluid milk marketed in Southern New England is processed by three processors and marketed at retail by at most eight chains including convenience chains.

**Fact: Fluid processors currently pay premiums.**

Hood is paying $1.20 per cwt in April 2003.

Guida is paying $1.15 per cwt in April 2003.

Garelick is paying 95 cents per cwt in April 2003.

**Fact: The proposed 140% wholesale price collar gives processors an incentive to pay farmers higher premiums.**

To honor the law the wholesale price that they charge retailers must be no more than 1.4 times the price that they pay for the raw milk. Let's use the average pay price for milk used in their products. If the raw milk used in their whole, 2%, 1%, and skim products averages $1.00 gallon (approximately where it is today) then processor <u>COULD</u> honor the law by cutting the wholesale price to $1.40 per gallon <u>BUT</u> this means they would be selling milk at a heavy loss. According to Dairy Technomics, Processing costs and current profit levels per gallon collected by Garelick for chains other than Stop & Shop which has a special contract, Hood and Guida are 58.3 cents per gallon for Garelick, 62.6 cents per gallon for Hood, and 62.5 cents per gallon for Hood.

To cover these processing and delivery margins, we predict that processors <u>WILL</u> pay higher premiums for their raw milk. A processor that seeks a 60 cent margin can obtain it by paying farmers a 50 cent per gallon premium raising the pay price from $1.00 to $1.50 per gallon. With the raw milk price at $1.50, applying the price collar 1.4 times $1.50 gives a wholesale price of $2.10 per gallon and a 60 cent processing margin.

**Query: What does a 50 cent a gallon premium mean to farmers on a per hundredweight basis?**

**Fact:** The answer depends on several parameters. First is the percent of fluid milk sold at retail as opposed to institutions such as schools and restaurants? Second is the proportion of milk that a processor sells in Connecticut, and third is how the processor and/or cooperatives that sell to the processor "blend" the premium back to farmers.

Consider Guida. If Guida pays a 50 cent per gallon premium on milk sold at retail but sells only half of its fluid at retail, then the per gallon premium paid across all raw fluid milk drops to 25 cents per gallon. Now assume that Guida sells 80% of its fluid milk in Connecticut and 20% in Massachusetts (via its private label contract with Big Y). Since the premium need be paid only on milk sold in Connecticut this cuts it to .8 x 25 = 20 cents per gallon. This amounts to 11.6 x .20 = $2.32 per hundredweight. This is the additional premium that Guida pays to Agrimark, its milk supplier. Now Agrimark has to decide how to pay this premium back to its members. Does it pay it as a fluid premium only to farmers that ship to Guida? Does it pay a blend price that includes farmers that ship milk to Connecticut processing plants for other dairy products as well? Does it blend it over all Agrimark members?

Now consider Hood. If Hood pays a 50 cent per gallon premium on milk sold at retail in Connecticut but it sells 75% via the retail distribution chain (a very unverified guess by us) then the per gallon premium for all raw fluid bought by Hood drops to 37.5 cents per gallon. Assume that the Hood Agawam plant sells only 30 percent of its milk in Connecticut and the rest in Massachusetts and Rhode Island. This drops the new fluid premium for all raw fluid bought by Hood to 11.25 cents per gallon. On a per hundredweight basis this is 11.6 x 1125 = $1.305. Again Agrimark, Hood's supplier, would receive this and have to return it to farmers in some fashion.

Consider Garelick-Franklin Massachusetts plant. This is the plant that sells nearly all of the Dean-Garelick private label and branded fluid milk into Connecticut.[1] If they pay a 50-cent premium on fluid sold at retail in Connecticut and they sell 80% of this

[1] Their East Greenbush New York plant sells a little into Litchfield County, and a small amount from their Tuscan (New Jersey) plant may come into Fairfield County. These plants would also be covered by the proposed law.

plant's output at retail, then the fluid premium is cut to 40 cents. Since a relatively small portion of the Garelick plant's sales are in Connecticut, assume 25 percent, the resulting premium for all raw milk shipped into the Garelick Franklin Massachusetts plant is 10 cents per gallon. This is $1.16 per hundredweight. Since Dairy Marketing Service has a full supply contract with this plant, they would collect this premium and pay it back in some fashion to their members.

**Fact: This law clearly would have more impact on farmers if Massachusetts and Rhode Island adopted it, but a Connecticut law as a stand alone program will benefit farmers. Also, it will benefit Connecticut farmers that sell to Guida most, unless Agrimark and DMS cooperate to establish a common pool.**