



Commonwealth of Pennsylvania
Milk Marketing Board

2301 North Cameron Street
Harrisburg, Pennsylvania 17110-9408
717-787-4194

The Milk Marketing Board is an independent state agency which primarily administers two laws: the Milk Marketing Law and the Milk Producers' Security Act. The Board is responsible for the economic regulation of milk in Pennsylvania from the cow to the consumer. The goal of that economic regulation is to provide a framework that

- enhances dairy farmer revenue,
- provides security for dairy farmers and milk dealers,
- allows fluid milk dealers and retailers to recover average costs.

To accomplish that legislative mandate, the Board administers a comprehensive milk pricing program that enhances the farm milk price while at the same time providing a fair and competitive price for consumers. The Board establishes minimum producer, wholesale, and retail prices. The minimum producer price includes a Board-mandated over-order premium on Class I milk produced, processed, and sold in Pennsylvania. The over-order premium is adjusted periodically based on evidence received at public hearings held by the Board. By maintaining minimum retail and wholesale prices, destructive price wars at those levels are eliminated and there is no pressure to reduce farm prices to meet competition. The key to the program is that Pennsylvania maintains the authority to regulate all sales of milk where possession transfers within the state's borders. It is also important to remember that the only transactions the Board may regulate are those that occur within our borders.

The Law requires the Board give equal consideration to all segments of the dairy industry when establishing minimum prices. The Board-established minimum prices are based on the costs incurred by the various segments of Pennsylvania's dairy industry to produce, process, distribute, and sell milk. The Board determines those costs based on evidence presented at public hearings.

Each year the Board holds at least two public hearings to determine the level of the Board-mandated over-order premium. The over-order premium is an amount that is paid to Pennsylvania producers over the applicable Federal Order price for Class I milk produced, processed, and sold in Pennsylvania. Current federal order pricing is intended to reflect national supply and demand dynamics by basing producer prices on wholesale sales of dairy commodities. This pricing structure has led to increased milk price volatility. The Milk Marketing Law provides Pennsylvania with the opportunity to enhance producer revenue in response to more local conditions. In recent years, the over-order premium has primarily been established based on market conditions in Pennsylvania and surrounding states; the expert recommendations presented at recent hearings have generally advocated extracting the greatest return possible from the market to benefit Pennsylvania producers while at the same time not threatening the markets of those Pennsylvania producers and providing milk to Pennsylvania consumers at a reasonable cost. At over-order premium hearings, the Board typically hears testimony from dairy producer cooperatives and dairy farmers representing the Pennsylvania Farm Bureau, the Pennsylvania Grange, and the Progressive Agriculture Organization. The Pennsylvania Association of Milk Dealers and the Pennsylvania Food Merchants Association also participate and provide testimony at over-order premium hearings.

The over-order premium directly impacts 15% - 20% of the milk produced in Pennsylvania. Since its inception in 1988 through the end of January 2018, the direct impact of the over-order premium has resulted in Pennsylvania producers receiving an additional \$842 million in revenue. The over-order premium also indirectly impacts most of the milk produced in Pennsylvania that it does not directly impact. This is because the over-order premium sets the bar that milk purchasers must meet when buying producer milk. The market for producer milk is competitive and purchasers of producer milk must pay competitive prices to attract milk to their plants. Without both the direct and indirect impacts of the over-order premium, under current conditions of relatively high raw milk supply and relatively weak demand, the price received by all Pennsylvania producers would be significantly lower.

Many people ask why the Board-mandated over-order premium is not payable on all milk produced in Pennsylvania. There are several reasons. First, Pennsylvania produces much more milk than our citizens consume. In 2016, Pennsylvania per capita milk production was 846 pounds, while per capita fluid milk consumption was approximately 154 pounds (2017 per capita production was 854 pounds, but 2017 per capita consumption data will not be available until September 2018); Pennsylvania farmers produce over five times more milk than Pennsylvania consumers drink. The balance of the milk is sold for fluid consumption outside Pennsylvania or to produce cheese, butter, and milk powder. Remember, the over-order premium is payable on milk sold as a fluid beverage that is produced, processed, and sold in Pennsylvania. Since most of the milk produced in Pennsylvania is used to manufacture Class II, III, and IV products such as cheese, butter, and milk powder, with some being used as Class I beverage milk outside Pennsylvania, it is not available to be directly impacted by the Board-mandated over-order premium.

So why does the Board not mandate a premium on the other classes of milk? The cheese, butter, and powder markets are national due to the less perishable nature of those products. In a national market there are many more opportunities to acquire milk at low prices. Pennsylvania milk and the cheese, butter, and powder manufactured from it compete nationally with products manufactured all over the country. Mandating a premium inside Pennsylvania for non-Class I milk could make that milk and the products manufactured from it non-competitive in that highly competitive national market.

Similarly, the Class I over-order premium must be established with the regional fluid milk market in mind – setting the over-order premium too high would at some point encourage milk purchasers to seek a lower cost supply from non-Pennsylvania producers or would encourage retailers to seek a lower cost wholesale supply outside Pennsylvania. As a matter of fact, at the most recent over-order premium hearing, held in December 2017, the Pennsylvania Farm Bureau, the Pennsylvania Association of Dairy Cooperatives (comprised of Dairy Farmers of America, Dairy Marketing Services, Lanco Dairy Farms Co-op, Land O’ Lakes, and Maryland and Virginia Milk Producers Cooperative), the Pennsylvania Association of Milk Dealers, and the Pennsylvania State Grange all testified that the over-order premium should be decreased due to the excess milk supply and low voluntary premiums being paid in surrounding markets.

While the Milk Marketing Law operates to enhance producer revenue, the Milk Producers’ Security Act provides protection for milk producers against non-payment by milk dealers. In simple terms, the Act requires purchasers of Pennsylvania producer milk to post a bond with the Board sufficient to cover one month’s worth of purchases. Bonds are posted annually and are based on the value of each milk dealer’s purchases during the prior year. The

Act also contains a provision that allows seven of the 193 milk dealers licensed by the Board to participate in a security fund; that limited number of dealers post a bond sufficient to cover approximately two weeks' worth of purchases and pay money into a security fund based on their purchases each month.

The Law also requires the Board to establish minimum wholesale and retail prices for packaged fluid milk products. Each year the Board holds a public hearing for each of the six Pennsylvania Milk Marketing Areas to determine the costs incurred by milk dealers to process, package, and deliver milk to stores in each area. Those costs are based on the weighted average audited costs of a representative cross section of milk dealers doing business in each of the areas. In addition to determining milk dealer costs, the Board also receives evidence at each of the public hearings regarding the average cost incurred by stores to handle and sell the packaged milk. In recent years, a base in-store handling cost has been determined in each of the areas and that base cost has then been adjusted monthly based on changes in the Consumer Price Index.

Broadly speaking, the average dealer costs are added to the minimum producer price, including the over-order premium, to arrive at the minimum wholesale price. The in-store handling cost is then added to the minimum wholesale price to arrive at the minimum retail price.

We know that there is some concern and confusion regarding the relationship between retail milk prices and the prices paid to producers. The Milk Marketing Law requires the Board to establish minimum wholesale and retail prices based on the costs incurred by a cross-section of each of those industry segments. There are three basic building blocks the Board uses to establish minimum retail prices: the Class I price received by the dairy farmer; the cost to

process raw milk, put it into consumer packages, and deliver those packages to a store; and the cost to handle and sell milk to the consumer in the store. The processor and retailer costs are determined once per year at a public hearing and remain virtually unchanged throughout the remainder of the year (some of the processor and retailer costs are subject to minor monthly updates based on increases and decreases in certain input costs, such as diesel fuel, natural gas, plastic resin, and the Consumer Price Index – the costs and how they are updated are outlined in each of the Area price orders, which are available on the Board website). The over-order premium is also updated monthly based on changes in diesel fuel costs. Basically, though, because the processor and retailer costs used to determine minimum retail prices remain essentially unchanged throughout the year, changes in the retail price are driven almost entirely by changes in the Class I price, including the changes in the over-order premium, received by dairy farmers – when the Class I producer price goes up, minimum retail prices increase, and when the Class I producer price goes down, minimum retail prices decrease.

Over the past 20 years, Pennsylvania dairy farmers have generally received 40% - 60% of the retail price of a gallon of 2% milk. During the same period, processor costs accounted for 28% - 37% of the retail price, while retailer costs accounted for 15% - 20%. The portion of the retail price of milk received by each segment of the dairy industry in Pennsylvania is fair, reasonable, and based on market forces and actual costs.

Another important consideration is that because prices at all levels are based on the average costs of a cross-section, less efficient processors and retailers have an incentive to reduce costs and become more efficient. If they do not, they will either lose business because they must sell at prices above the minimum price, or they will lose money by selling at minimum prices, which are below their costs.

In addition to establishing minimum prices and administering the Milk Producers' Security Act, the Board operates a bulk tank calibration unit to ensure that farmers' milk is being weighed accurately. The Board also certifies milk weighers and samplers to ensure that producer milk is measured and tested accurately so that Pennsylvania producers receive accurate and timely payment for their milk.

The Pennsylvania dairy industry is unique. Pennsylvania has a larger proportion of small- to medium-sized dairy operations than other important dairy producing states. Pennsylvania also has an unparalleled diversity of dairy processors and manufacturers, providing Pennsylvania's consumers with a greater variety of products and brands to choose from. This large array of processors also provides Pennsylvania producers enhanced opportunities and increases the competition for Pennsylvania-produced milk.

While Pennsylvania currently ranks 7th in the country in milk production, we rank 2nd in the number of dairy farms. In 2017, the average Pennsylvania herd size was 80 cows, the smallest in the nation. A 2011 study done at Penn State indicated that the relationship between rural economic conditions and the dairy industry was not a simple function of the number of cows and amount of milk produced, but rather that the number of dairy farms was a more accurate indicator of vibrant rural communities.

Dairy farming and the dairy industry as a whole have changed significantly over the past ten years. Milk production is increasing, but the number of dairy farms has decreased significantly. And despite the increase in milk production, per capita consumption of fluid milk products has declined dramatically, leading to Class I processing plants closing across the United States.

Despite these changes, Pennsylvania has maintained its unique character. While Pennsylvania has lost dairy farms, it has lost them at a much lower rate than other important milk producing states and the United States as a whole. Pennsylvania has also not lost significant Class I processing capacity, thereby maintaining nearby markets for Pennsylvania producers. The tables below show some of the changes in the dairy industry since 2007.

	2007 milk production (000,000 lbs)	2017 milk production (000,000 lbs)	07-17 increase
California	39,798	40,683	2.2%
Wisconsin	24,080	30,320	25.9%
New York	12,103	14,912	23.2%
Idaho	11,549	14,627	26.7%
Texas	7,384	12,054	63.2%
Michigan	7,625	11,231	47.3%
Pennsylvania	10,682	10,938	2.4%
United States	185,654	215,466	16%

	2007 milk per cow	2017 milk per cow	07-17 increase
California	22,440	22,755	1.4%
Wisconsin	19,310	23,725	22.9%
New York	19,303	23,936	24.0%
Idaho	22,513	24,378	8.3%
Texas	18,982	23,589	24.3%
Michigan	22,761	26,302	15.6%
Pennsylvania	19,422	20,834	7.3%
United States	20,204	22,941	13.5%

	2007 herds	2017 herds	07-17 decrease	16-17 decrease	2007 herd size	2017 herd size	07-17 increase
California	1,960	1,390	29.1%	2.1%	925	1,258	36.0%
Wisconsin	14,170	9,090	35.9%	4.5%	88	141	60.2%
New York	5,770	4,490	22.2%	3.4%	109	139	27.5%
Idaho	665	510	23.3%	1.9%	771	1,176	52.5%
Texas	700	400	42.9%	0%	556	1,278	130.0%
Michigan	2,440	1,750	28.3%	3.3%	137	244	78.1%
Pennsylvania	8,010	6,570	18.0%	1.2%	69	80	16.0%
United States	59,130	40,219	32.0%	3.8%	155	234	50.3%

The table above shows that in 2007, 13.5% of US dairy farms were located in Pennsylvania; in 2017, 16.3% of US dairy farms were located in Pennsylvania.

	2007 per capita production	2016 per capita production	07-16 change	2007 per capita Class I consumption	2016 per capita Class I consumption	07-16 change
Pennsylvania	850	846	-0.47%	182	154	-15.4%
United States	616	656	6.5%	182	154	-15.4%